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The Manufacturers' Organisation

# MANUFACTURING OUTLOOK

## 2020 QUARTER 1

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# FOREWORD


**Seamus Nevin**
Chief Economist
Make UK

**Tom Lawton**
Head, BDO Manufacturing
BDO LLP


Next to Mornington Crescent underground station in London stands a statue. It was erected to commemorate Richard Cobden MP, negotiator in 1860 of the first modern free-trade agreement. Cobden has been memorialised all over the country for his contribution to the UK economy, especially by grateful manufacturers in the north of England.

The Cobden-Chevalier Treaty he negotiated with his French counterpart sharply reduced duties on goods flowing between Britain (though not Ireland) and the continent, as this country embarked on a new chapter as a trading nation.

International trade treaties today are very different from the model first developed by Cobden-Chevalier. For starters, it is no longer a matter of negotiating over the course of a few lunches and an audience with Emperor Napoleon III, tariff cuts on French wine and agricultural produce, in return for more market access for British coal, iron, and manufactured goods.

Negotiating modern trade deals is an extremely complex and technical activity. Trade treaties today are vast documents comprising significant commitments on sensitive matters of domestic policy, ranging from food standards, to data protection, to immigration rules, to public procurement.

As Britain again embarks on a new chapter as a trading nation, manufacturers not just in the north of England but across the UK, will be central to ensuring success. Fittingly, this is Make UK and BDO's first *Manufacturing Outlook* report to include Northern Ireland, and therefore cover the whole UK.

Manufactured goods currently account for just under half of all UK exports but the sector has experienced a tough period since the 2016 EU referendum. Make UK's Q1 2020 report is our first edition since the UK left the EU in January. As such, this report is a barometer of how the sector is faring and from where we hope it will grow.

To that end, we find that the industry has, thankfully, begun to return to a more normal pattern after the topsy-turvy past 12 months.

A lack of investment was a key shortcoming in recent editions but our latest survey shows investment intentions have shot up since the start of the year.

This couldn't come at a more important time. The UK's preparations for our global trading future coincide with a trough in the business cycle and tough global conditions while trend growth is currently at its worst point since the 1970s.

As government spending provides the stimulus, and businesses gear up to develop new products and target new markets, economic performance should start to improve.

However, the rise in investment intentions has been coupled with a decrease in employment intentions, suggesting that firms are planning to spend their money on new factories and machinery, rather than new staff. All investments will, of course, be subject to revision until the impact of the ongoing COVID-19 outbreak becomes clear.

Unfortunately, domestic orders remain low but of greater concern is the fall in demand from customers overseas. This decline in sales epitomises the need for firms to take advantage of the Brexit transition period to prepare for the impending changes to our international trade relations.

The fact that both UK and export prices have improved should help manufacturers benefit from a boost to their cash-flow this quarter.

So, although the results for the first *Manufacturing Outlook* of the decade are not universally positive, most firms are more confident about the future (although, as with the Cobden-Chevalier treaty, Northern Ireland is feeling somewhat excluded).

# HEADLINES

Make UK's Q1 2020 *Manufacturing Outlook* report, in partnership with BDO, is our first edition since the UK left the EU in January. This first edition of the new decade is also the first to include data for Northern Ireland, with thanks to our partners Manufacturing NI, and therefore cover the whole UK. As such, this report is a barometer of how the sector is faring and direction it has moved since last quarter.

Last year was a difficult time for UK manufacturing. Now, after a series of stockpiling highs and investment lows, overall, the industry has begun to return to a degree of cyclical normality. Although the results are not entirely positive, confidence amongst manufacturers is high and many firms are gearing up to release new investment. However, Northern Irish firms are somewhat less optimistic. This is partly explained by the size of the manufacturing economy there – which is greater than the UK average share of 10% – as well as their relatively higher reliance on the EU market for goods exports when compared to England, Wales and Scotland.

| INDICATOR | BALANCE | CHANGE | |
|---|---|---|---|
| Confidence | 6.61 | ↑ | Confidence in the UK economy up since Q4 last year |
| Output | 2% | ↓ | Output balance down as stockpiles wound down |
| UK orders | -3% | ↑ | Domestic orders negative but trending upwards |
| Export orders | -2% | ↓ | Exports orders negative |
| Employment | 3% | ↓ | Recruitment balance trends downwards |
| Investment | 20% | ↑ | Investment intention jumps to highest since late 2018 |

Source: Make UK Manufacturing Outlook Survey

Our previous report saw output jump to 11% as a result of mild safety stockpiling. The latest figures show manufacturers have wound down these stockpiles and, as a consequence reported a balance of 2%.

Domestic orders have now been negative for three straight quarters, the last time UK orders seemed this dire was between 2015 and 2016 when we saw six consecutive quarters of negative results. Of greater concern is the steep contraction of export orders this quarter to -2% as the Christmas boost fades away.

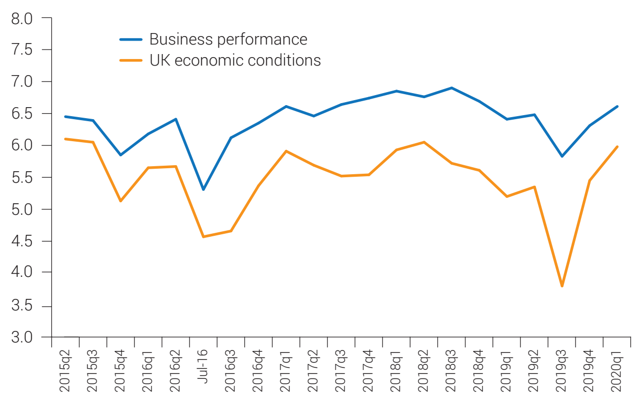
A lack of investment has been a key shortcoming in unlocking UK manufacturing potential for a long time now. Our latest survey results reported investment intentions at 20%, markedly higher than last quarter's 3%. However, the rise of investment intentions has been coupled with a decrease in employment intentions – indicating that manufacturers are looking to invest in long-term capital stock instead of short-term human resources.

Both UK and export prices have improved this quarter, but margins failed to follow suit. Particularly export margins, which declined – indicating that exporting manufacturers have seen profitability fall.

Confidence has also improved slightly since Q4 last year and the boost has been shared quite evenly between most regions too.

### Confidence up from last quarter

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




Source: Make UK Manufacturing Outlook Survey

# OUTPUT

The last quarter of 2019 saw the output balance increase to 11% following a sharp decline earlier in the year. This time last year was also the beginning of unprecedented precautionary stockpiling in the run up to the first Brexit deadline. The start of the new decade has produced a diminished result as output was 2% for Q1 2020. This result emphasises that the confidence boost achieved by the industry immediately after the election did not translate into significantly improved output performance for the sector.

It must be noted that this quarter's results analyse the final three months to January 2020 whereby manufacturers had knowledge of the outcome of the general election and our EU exit on January 31st and subsequent transition period. Hence, the need for precautionary stockpiling reduced significantly in the short-term as UK manufacturers began to run down their stocks.

Basic Metals remains a significant area of concern. The subsector reported a -29% output balance last quarter. The latest balance for Basic Metals reported at -20%, remaining negative due to uncertainty about the financial viability of key firms in the subsector. However, the news that Jingye have now purchased British Steel will hopefully reduce that uncertainty in the next few months.

Metal Products has once again followed the demand path carved by the Basic Metals sector by declining to -7%.

Rubber and Plastics reported a negative output balance of -20% this quarter. However, contrary to last quarter – expectations for the sector are significantly more optimistic at 25%, as 2020 promises to be a defining year for the environmental sustainability agenda. Shifting priorities from household consumers as well as businesses will result in developments that will increase demand for goods in this sector.

**PAST THREE MONTHS** ↓ 2% | **NEXT THREE MONTHS** ↑ 26%

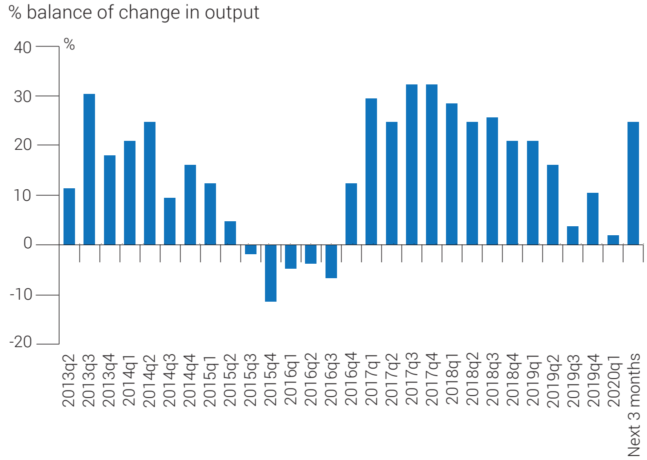
However, greater clarity in the political and economic climate has appeared to restore a degree of normality in the manufacturing sector. Thus, UK manufacturers expect a significant improvement in their output balance over the next three months to a balance of 26%.

Our last edition reported improved balances for a number of sectors, which was the result of modest stockpiling that took place within Q4 2019.

Last quarter, output in the Electrical and Mechanical Equipment sectors performed well. Although still positive, this quarter's results show both subsectors reported a weaker balance. A decline in the Electronics subsector was unexpectedly reported in our last edition. It has generally performed well in recent years due to global demand for automation technologies. Difficulties in obtaining semiconductors and passive components have been cited as a cause of the recent woes in the industry.

### Output falls as stockpiles are wound down

% 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 | -20% | 10% |
| Metal Products | -7% | 19% |
| Mechanical | 4% | 28% |
| Electronics | -5% | 50% |
| Electrical | 12% | 18% |
| Rubber & Plastics | -20% | 25% |
| **TURNOVER** | | |
| £0-9m | -2% | 27% |
| £10-24m | -1% | 21% |
| £25m and over | 2% | 27% |

Source: Make UK Manufacturing Outlook Survey

# ORDERS

The total order balance increased to 4% this quarter, an improved result that keeps overall orders in positive territory.

Our previous *Manufacturing Outlook* reported a negative balance for domestic orders, following a shock collapse towards the end of Q3 2019. In this edition, domestic orders remained negative for the third quarter in a row and continue to perform worse than export orders – which has also shockingly gone negative too.

This quarter we observed a number of subsectors perform poorly in domestic trade. In particular, Basic Metals reported a balance of -30%, worse than last quarter's 21%. Metal Products also reported a negative balance of -6%, reflecting the subsector's close relationship to Basic Metals.

Mirroring the demise of its output balance, the Electronics subsector also reported a further contraction of domestic orders to -9%. Although manufacturers are positive about the next three months, the impact of delayed shipments due to the coronavirus is yet to be seen in full.

| | | | | | | |
|---|---|---|---|---|---|---|
| **UK ORDERS** | PAST THREE MONTHS | ↑ | -3% | NEXT THREE MONTHS | ↑ | 28% |
| **EXPORT ORDERS** | PAST THREE MONTHS | ↓ | -2% | NEXT THREE MONTHS | ↑ | 26% |
| **TOTAL ORDERS** | PAST THREE MONTHS | ↑ | 4% | NEXT THREE MONTHS | ↑ | 33% |

Until last quarter, our surveys highlighted positive, albeit declining, values across all measures of orders since Q4 2016. A marginal improvement in domestic orders has had the fortunate impact of outweighing the decline of exports pushing total orders in an upward direction in what is a similar set of results from *Manufacturing Outlook* Q1 2019. Expectations for the next three months are also very positive at 33% for total orders.

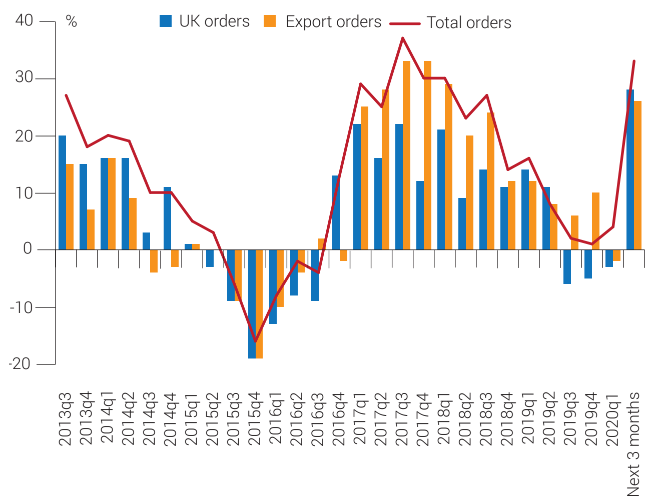
For the first time since Q3 2016 export orders is negative, but the gap between output and orders has narrowed. Our recent EU-exit has encouraged UK manufacturers to opt for winding down stockpiles, instead of producing new goods, to fulfil existing orders. Given orders themselves are generally weak – an increase in output is less necessary at the moment.

## UK ORDERS

UK orders improved to -3% this quarter but this weak performance is a growing concern. Unambiguously, the poor performance of domestic orders has stabilised into negative territory, even as economic conditions return to normality. Time will reveal whether this performance is the new normal.

**Export orders negative for the first time since Q4 2016**

% balance of change in orders




Source: Make UK Manufacturing Outlook Survey

The Electrical Equipment subsector has reported positive orders for two consecutive quarters now. It was the only subsector of the top five to report a positive balance in domestic orders this quarter.

## EXPORT ORDERS

This year is a critical time for UK manufacturing as the government negotiates new trade deals with both the EU and the Rest of the World (ROW).

Following a strong end to 2019, which saw export orders jump to 10% thanks to the cyclical boost that comes every festive period, the first quarter of this year has reported a shockingly low -2% on balance for export orders. This is the first time export orders have dropped into negative territory since Q4 2016. Nevertheless, the performance of export orders is marginally better than domestic orders.

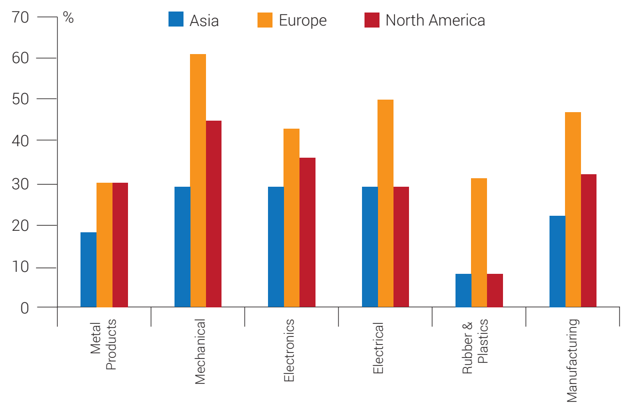
Basic Metals, Metal Products, and Rubber & Plastics all reported negative balances for export orders. In contrast to last quarter, Rubber & Plastics reported a worse balance due to a weak international automotive market.

The steep decline in exports was not shared equally between the various subsectors – Electronics, Electrical Equipment, and Mechanical equipment reported positive balances. This is a reflection of foreign customers' growing demand for automated machinery.

Even though we have now left the EU, the EU remains top of the list as the most important foreign market for UK manufacturers, and will likely continue to do so after the transition period, regardless of the outcome of trade negotiations. The top three is then completed by North America in second place, followed by Asia.

### The EU remains a priority market

% 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 | -30% | 20% | -38% | -25% | -40% | 20% |
| Metal Products | -6% | 15% | -13% | 11% | 4% | 19% |
| Mechanical | -7% | 39% | 5% | 37% | 6% | 42% |
| Electronics | -9% | 36% | 15% | 50% | 0% | 55% |
| Electrical | 18% | 24% | 12% | 24% | 18% | 29% |
| Rubber & Plastics | -20% | 8% | -27% | 13% | -20% | 0% |
| TURNOVER | | | | | | |
| £0-9m | -10% | 23% | -1% | 19% | 4% | 29% |
| £10-24m | 0% | 25% | -8% | 26% | 5% | 33% |
| £25m and over | 0% | 35% | 5% | 22% | 5% | 28% |

Source: Make UK Manufacturing Outlook Survey

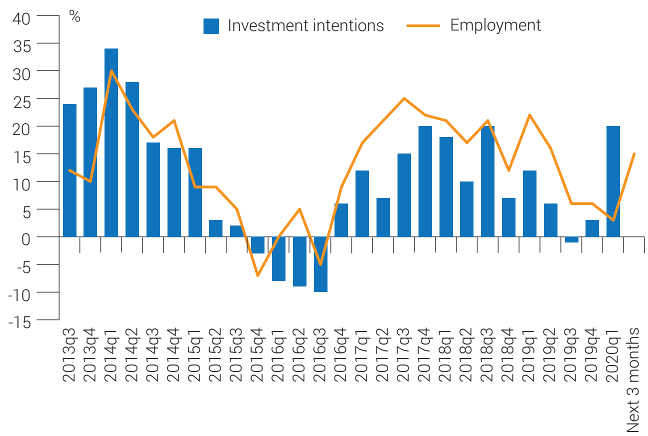
# EMPLOYMENT & INVESTMENT

By and large, investment intentions remained positive in 2019 but actual measured business investment was quite poor. This was a reflection perhaps of the holding pattern businesses maintained over the past year, refraining from action while they awaited clarity on post-Brexit trading arrangements.

While we can now see that there has been a marked improvement in investment intentions since last quarter, only time will tell whether we will actually see businesses loosen their purse strings, but there is an added air of confidence at the moment, likely thanks to the clarity provided by the election result and exit from the EU at the end of January.

## Employment beneath investment

% balance of change




Source: Make UK Manufacturing Outlook survey

| | | | | | | |
|---|---|---|---|---|---|---|
| **EMPLOYMENT** | PAST THREE MONTHS | ↓ | 3% | NEXT THREE MONTHS | ↑ | 15% |
| **INVESTMENT** | NEXT TWELVE MONTHS | ↑ | 20% | | | |

This quarter, employment balance is reported as marginally positive. Although an undesirable result on first look, it is unlikely to be a shock to both the wider industry and manufacturers who saw this downward trend developing since the last year. However, the lack of growth may not be as negative as it seems, with the very tight labour market we have in the UK at the moment, employment growth cannot occur in earnest without the creation of new jobs.

What is more unusual is that, for the first time since the end of 2015, employment balance is reported to be lower than investment intentions. Typically we see employment leading above investment, as employment itself can be seen to be low-commitment human capital investment.

This result is likely a sign of businesses taking different corporate strategies forward during this EU exit transition period and signals that firms plan to recommence investing in their factories and machinery, having not done so on a large scale since before the EU referendum in 2016.

However, some businesses have reported that their plans for increased capital expenditure are as a result of having to refit their production lines to manufacture different products due to impending regulatory divergence following from the UK's exit from the EU.

## Employment and Investment summary

% balance of change

| | EMPLOYMENT | | INVESTMENT |
|---|---|---|---|
| SECTOR | PAST THREE MONTHS | NEXT THREE MONTHS | NEXT TWELVE MONTHS |
| Basic Metals | -10% | 0% | 11% |
| Metal Products | -6% | 2% | 13% |
| Mechanical | 6% | 24% | 20% |
| Electronics | -9% | 14% | 23% |
| Electrical | 6% | 12% | 18% |
| Rubber & Plastics | -33% | -14% | 15% |
| **TURNOVER** | | | |
| £0-9m | 2% | 10% | 17% |
| £10-24m | 3% | 10% | 14% |
| £25m and over | -8% | 15% | 19% |

Source: Make UK Manufacturing Outlook Survey.

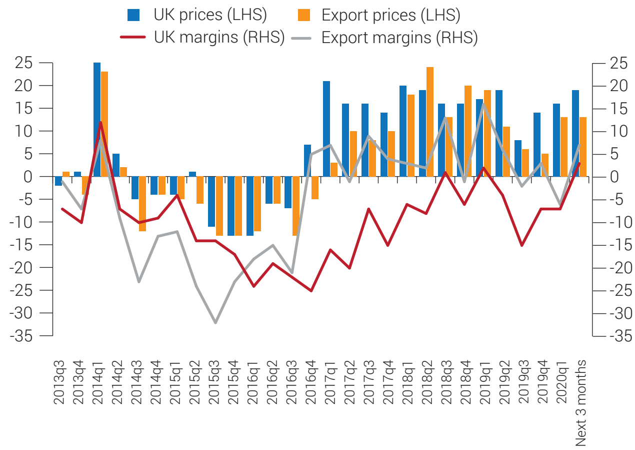
# PRICES & MARGINS

In summary, last quarter saw UK prices increase markedly to 14% whilst export prices actually declined very slightly to 5%. At the time, this was coupled with an increase in margins across both the domestic and international markets leading to an improvement in profitability for UK manufacturers.

The latest data reports a mixed batch of results as both UK and export prices improved, to 16% and 13% respectively. UK margins remained fixed at -7%, albeit still negative, this widens the gap between domestic prices and margins – indicating improved profitability domestically. However, manufacturers have seen profitability worsen in the export markets as margins fell to -6%. Therefore, this change in margins will impact component makers that rely more on export markets for orders disproportionately than those firms that mainly service the domestic market.

### Domestic prices increase and margins worsen

% balance of change




Source: Make UK Manufacturing Outlook Survey

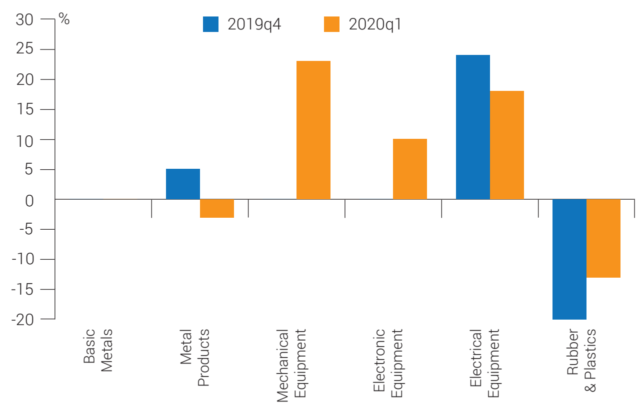
| | | | | | | |
|---|---|---|---|---|---|---|
| **UK PRICES** | PAST THREE MONTHS | ↑ | 16% | NEXT THREE MONTHS | ↑ | 19% |
| **EXPORT PRICES** | PAST THREE MONTHS | ↑ | 13% | NEXT THREE MONTHS | ↔ | 13% |
| **UK MARGINS** | PAST THREE MONTHS | ↔ | -7% | NEXT THREE MONTHS | ↑ | 3% |
| **EXPORT MARGINS** | PAST THREE MONTHS | ↓ | -6% | NEXT THREE MONTHS | ↑ | 7% |

Manufacturers' expectations are that firms will experience fewer cash-flow concerns in the next quarter.

In the last three months the Brent Price of oil varied between $59 and $63 per barrel, which is similar to the previous quarter's average price of $60 per barrel. However, Saudi Arabia's response to start an oil price war could see the cost of fuels fall in the near future. As of publication, the latest Sterling-Euro exchange rate is €1.2 – this is a strong rate when compared to recent years but it is not a result of the UK economy performing better now than before. Instead, Germany recently fell short of its GDP forecast which caused the Euro to fall in recent weeks.

### Rubber and Plastic sector squeezed further

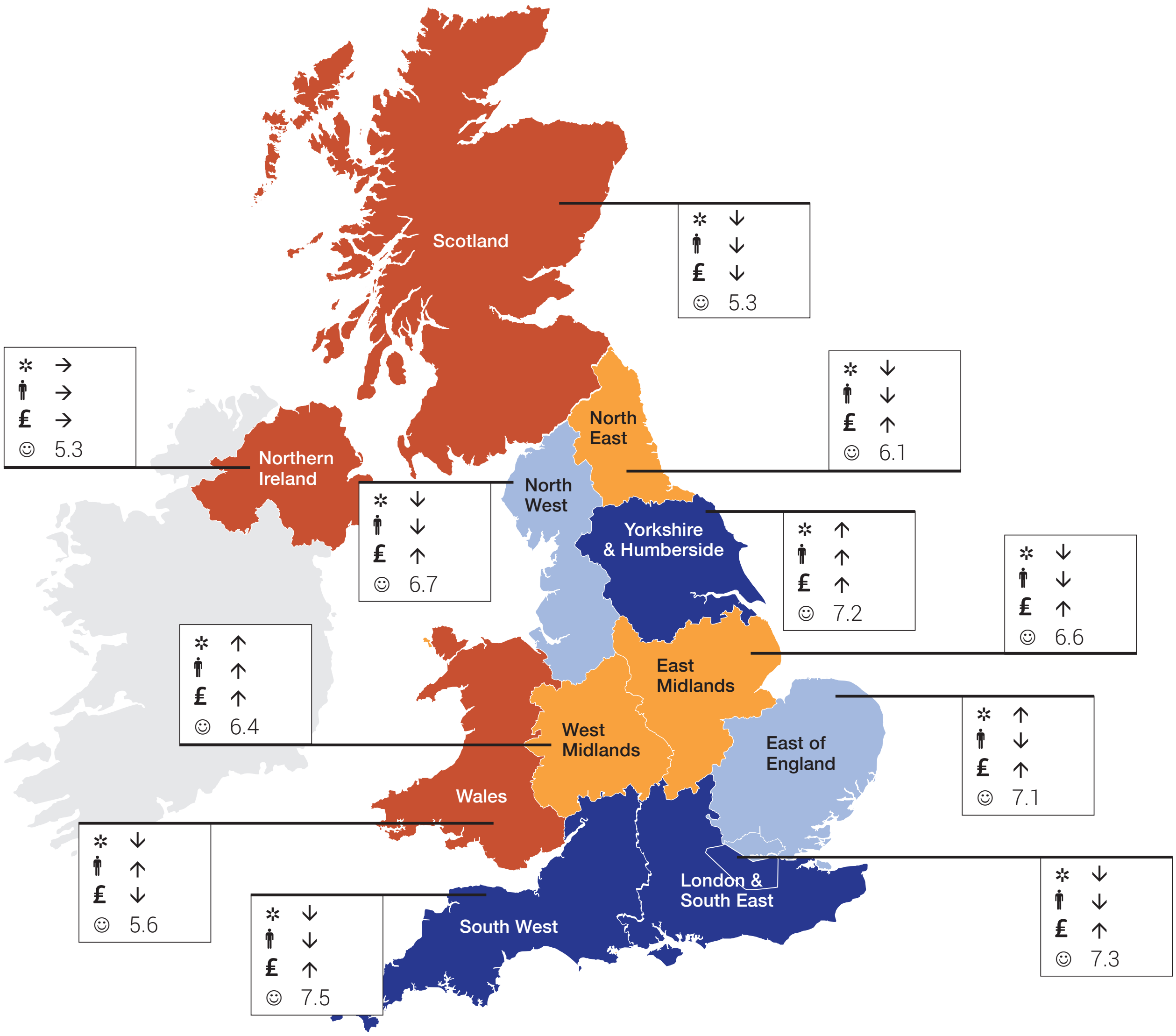
% balance of change in export prices in the past three months




Source: Make UK Manufacturing Outlook Survey

# NATIONAL & REGIONAL

Business confidence is positive in all regions and nations this quarter, with each region seeing an increase from their respective Q4 2019 results. Scotland and Wales, however, reported business confidence of 5.3 and 5.6 respectively, which though a positive score, is only marginally above the '5' threshold, which would indicate negative confidence. Northern Ireland posted the lowest level of business confidence at 5.3. The majority of regions saw a decrease in both output and employment on the previous quarter, but future investment intentions were high.




KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
✲ OUTPUT
EMPLOYMENT
£ INVESTMENT
☺ BUSINESS CONFIDENCE

The map is coloured according to business confidence levels

HIGH CONFIDENCE

LOW CONFIDENCE

Source: Make UK Manufacturing Outlook Survey

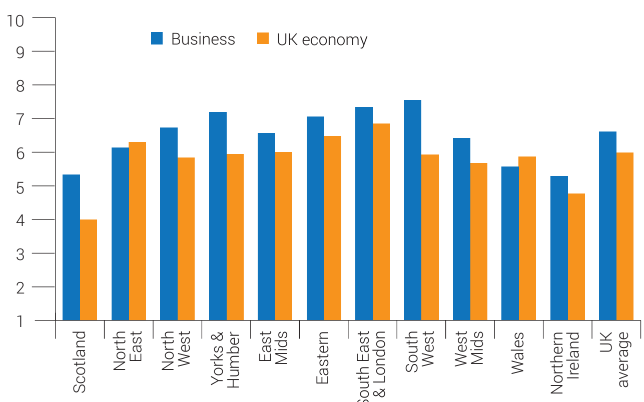
Yorkshire & the Humber and the East of England were the only regions to report both very positive output and order figures, whilst also improving on their results from last quarter. A likely factor for this is that both of these regions have a very large Food & Drink industry, a subsector that typically enjoys more consistent demand than other subsectors, affording it, and the regions that host it, a degree of insulation from the volatile economic circumstances that have affected other subsectors and regions in recent times. Food & Drink manufacturing accounts for 15.2% and 23.4% of the manufacturing industry in the East of England and Yorkshire & the Humber regions respectively.

The West Midlands, where the Transport Equipment sector accounts for 36.5% of the manufacturing industry, was the only other region to see positive change in output performance compared to last quarter. However, this balance remains negative, as it did last quarter.

In contrast to last quarter, the majority of nations and regions saw declines in their manufacturing employment balance.

**Firm level confidence remains positive and up from last quarter for the majority**

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




Source: Make UK Manufacturing Outlook Survey.

## BUSINESS CONFIDENCE INDICATORS

As usual, manufacturers' confidence in their own businesses is higher than that of the overall UK economy. While UK confidence was lower on average than business confidence, all nations and regions reported positive confidence in the UK economy except for Scotland and Northern Ireland.

This is likely a reflection of the relative proportion that manufacturing holds in both Scotland's economy (10.2%), and Northern Ireland's (15.2%), both of which are above the UK average 10%. However, the sample for Scotland's confidence indicator was fewer than other nations and should not be given significant weighting. But for Northern Ireland – its economy also has a high reliance on goods exports to the EU, with 60% of all outbound trade in goods received by EU members. The cost of failing to secure a trade deal with the EU will be felt by Northern Ireland more than any other nation. The unique nature of its post-Brexit trade arrangements may also be weighing on manufacturers' confidence relative to the rest of the UK.

## 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 | 2 | 28 | 7 | 39 | 1 | 9 |
| North East | 12 | 24 | 6 | 13 | -6 | 41 |
| North West | -9 | 24 | 23 | 5 | -14 | 0 |
| Yorks & Humber | 26 | 68 | 21 | 58 | 26 | 26 |
| East Mids | -35 | -15 | -50 | 30 | -15 | 5 |
| Eastern | 24 | 42 | 33 | 35 | 10 | 30 |
| South East & London | 13 | 41 | 25 | 50 | 3 | 8 |
| South West | -7 | 53 | 20 | 40 | 0 | 13 |
| West Mids | -8 | 21 | -8 | 29 | -4 | 0 |
| Wales | -29 | -33 | -29 | -29 | 14 | -14 |
| Northern Ireland | -36 | -8 | -24 | -12 | -4 | 4 |

Source: Make UK Manufacturing Outlook Survey

# ECONOMIC ENVIRONMENT

The start of 2020 saw the performance of UK manufacturing stabilise after the turmoil of last year.

Following 9 months of consecutive downturn, manufacturing emerged in January from its longest decline since the 2008 Financial Crisis, as the seasonally adjusted PMI rose to a neutral 50.0. Following disruptions to the traditional business cycle for much of the last two years, the industry has begun to return to a degree of cyclical normality.

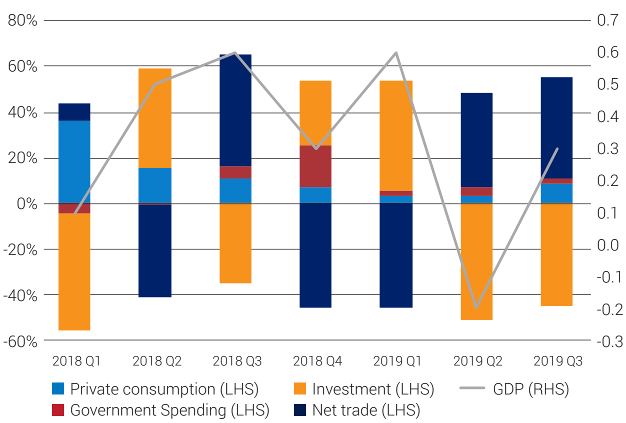
This came off the back of December's general election result which has reduced levels of political uncertainty, as well as the end of the US-China trade dispute. However, the ongoing spread of COVID-19 is causing concern. HMG estimate up to a fifth of UK workers could be off sick at the same time.

The assassination of Iran's military commander, Gen Qasem Soleimani, has thankfully not had the anticipated impact on global trade that many initially feared.

However, US President Donald Trump has since turned his attention against the EU and UK. Mr Trump is now focusing more attention on trade relations with the EU after striking a "phase one" agreement with Beijing in December that stopped further escalation of economic hostilities between the two powers. That said, at the time of writing, the EU's chief trade negotiator, Phil Hogan, said he was optimistic of progress in trade talks and hopes to broker a "mini deal" with the US to curb transatlantic tensions before Washington follows through with an increase in punitive tariffs on Europe's aircraft sector.

### GDP shows no growth in Q4 2019

Contribution to real GDP q-on-q growth




Source: ONS

President Trump has repeatedly threatened to hit EU and UK car exports with punitive tariffs in order to pressure the bloc into doing a deal on his terms. The EU has sought instead to find common ground on an alternative agenda and is hopeful that the president will be reluctant to stoke tensions that could rattle the US economy in an election year.

Although the rate of inflation is the fastest since last August, at 1.8% it remains modest compared to its long-run survey average and below the Bank of England's (BoE) target of 2%. The bump came as a surprise to analysts, who had forecast the rate to rise half as much to 1.6%. The rise was seen as a vindication of the BoE's decision not to cut rates at its January meeting of the Monetary Policy Committee (MPC), despite fears of a potential recession. However, as a result of the economic risks posed by the outbreak of COVID-19 the BoE have now cut the base rate to 0.25%.

The Office of National Statistics (ONS) said the main drivers of the increase in inflation were increases in the housing and household services – gas and energy bills – as well as transport, which rose 0.2% on rising fuel pump prices. Energy prices, which had taken a hit on the back of Ofgem's introduction of the initial price cap last year. Indeed, the cost of crude oil is at its lowest in a year having fallen 20% since January, although Saudi Arabia's decision to increase crude oil production by 2.5m barrels a day could see the price fall further and is already undercutting shale gas producers in the US.

Exchange rate volatility has moderated, albeit the Pound's post-election glow has recently evaporated. Due to parts of the European Union underperforming on its GDP expectations, the latest Sterling-Euro exchange rate is approximately €1.2. From the UK's perspective Sterling has fared better in recent months as a calmer political environment has helped reduce volatility in the effective exchange rate. However, ominously the OBR now say even with a EU trade deal UK productivity will in future be 4% lower than otherwise.

Business confidence though up, however, remains fragile and concerns about our future trade rules mean export orders are still falling as foreign customers remain reluctant to buy British goods.

The domestic market also remains weak. UK retail sales were their lowest in 25 years last year.

Net migration to the UK has also fallen to its lowest level since 2003 – before the totemic 2004 EU enlargement. The ONS says this was down to fewer people coming to Britain for work, while a record high returned home. Many manufacturers will be worried about potential labour shortages under the Home Office's proposed new visa system. Compounding this worry further, The Office for Budget Responsibility is now set to revise down its long-term economic growth forecasts for the UK in light of the post-Brexit crackdown on EU immigration.

The national living wage is set to rise 6.2% in April, in what will be the biggest single increase ever. That will push up firms' input costs. But the long term earnings squeeze has meant that average pay only returned to its pre-crisis peak last month, a full 12 years after the Global Financial Crisis.

Nevertheless, improvements in investment intentions are beginning to show. The Spending Review last September lead the way when HMG announced £13.8bn of extra taxpayer-funded government consumption in 2020-21, officially marking the end of austerity. However, there remains, as yet, no indication of a largescale boost to output from firms.

Indeed, the Office for Budget Responsibility (OBR) reports that business investment has flatlined, disappointing even the relatively modest 9% growth over three years that they forecast just after the 2016 referendum.

In addition, figures from the Institute for Government (IfG) indicate that the government will have spent £6.3bn on Brexit preparedness by the end of April. They have already pledged another £2bn for 2020-21.

On top of that, the £100bn of extra infrastructure spending planned over the next five years will add a percentage point per annum to GDP. Heathrow Airport, however, won't be among this spending after plans for a third runway at the terminus were thrown into doubt following a Court of Appeal ruling that the government's decision to allow the expansion was unlawful because it did not take climate commitments into account. Follow up plans for a £28.8bn roads programme could also now be challenged in the courts for breaching the UK's laws on climate change. Heathrow has said it will challenge the decision, but the government says it will not appeal.

Added to this the global economy is continuing to struggle.

After almost two years of trade tensions with the US, China's economic growth was at a 30-year low even before the coronavirus outbreak began. News that the virus has now spread to the UK will cause widespread concern among manufacturers many of whom are already reporting difficulties in sourcing input goods as a result. Of further worry is the potential impact the impounding of freight vessels in affected regions may have on the UK's ability to export goods in the coming months – even for firms who do no trade with China. Some Make UK members have reported an inability to ship goods overseas because the ships they need are stuck in China while freight transporters are also reluctant to have their crew held in quarantine for a month per journey (two weeks upon arrival at their destination, two weeks upon their return).

Meanwhile, Bank of England governor Mark Carney has warned that the coronavirus outbreak could lead to a downgrade of the UK's economic growth prospects. The UK Government currently expects that up to a fifth of the entire workforce could be off sick during the peak of the epidemic in the UK.

Upon news of the disease's spread beyond China's borders stock markets across the globe suffered their worst week since the global financial crisis of 2008 as fears over the impact gripped investors. Markets in Europe fell sharply, with London's FTSE 100 index sinking sharply. Asian markets too saw big falls, while in the US, the Dow Jones recorded its biggest daily points drop in history. Global markets have remained turbulent since.

Investors are clearly worried the coronavirus impact could spark a global recession. Significant market volatility has been observed as the coronavirus spreads globally, although the market has rapidly recovered in the short term as investors have developed renewed belief that governments and central banks will intervene to tackle the economic hit of the virus. Italy has already taken steps to quarantine its citizens, and other countries may follow suit.

To that end, the virus could not have come at a more concerning time. Central banks around the world were already warning that, given levels of global indebtedness, they are running low on ways to fight any potential recession. Observed market volatility so far has been particularly short-term, we have yet to see the full impact on the global economy of the coronavirus, a picture that will become clearer in the coming weeks and months. The World Bank (WB) has also warned recently of its concerns about the mounting $55tn emerging market debt pile.

The appointment of Andrew Bailey as the next Governor of the Bank of England could mark a change of direction for the Old Lady but the warning by outgoing Governor Mark Carney about the importance of addressing climate change will remain a key objective for firms this year. The UK is due to host the 2020 United Nations Climate Change Conference, known as COP26, in Glasgow this November.

Most manufacturers have started already but the struggling UK steel, automotive, and aerospace sectors may find it more difficult to adapt.

## UK Economic Forecasts

% change except where stated

| | 2019 | 2020 | 2021 |
|---|---|---|---|
| **TRADING ENVIRONMENT** | | | |
| Exchange rate (€/£) | 1.14 | 1.21 | 1.21 |
| Exchange rate ($/£) | 1.27 | 1.32 | 1.33 |
| Exports | -1.1 | -1.5 | 1.8 |
| Imports | 2.7 | 0.9 | 2.7 |
| Current account (% GDP) | -3.9 | -3.8 | -3.8 |
| **OUTPUT** | | | |
| Manufacturing | -1.5 | -2.12 | 1.13 |
| GDP | 1.3 | 0.7 | 1.8 |
| **COSTS AND PRICES** | | | |
| Average earnings | 3.5 | 3.01 | 3.15 |
| Oil price (Brent Oil $/bl) | 64.4 | 62.4 | 65 |
| **EMPLOYMENT** | | | |
| Manufacturing (000s) | 2,722 | 2,680 | 2,645 |
| Rest of economy (000s) | 35,660 | 35,752 | 36,064 |
| Unemployment rate (%) | 3.8 | 3.8 | 3.7 |

Source: Oxford Economics and Make UK

## International Economic forecasts

% change

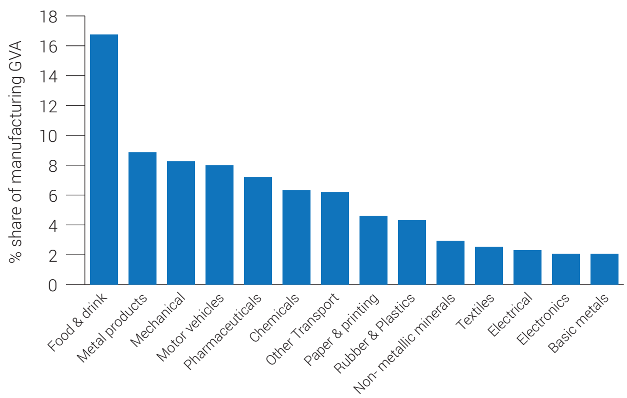
| | GDP | | | INFLATION | | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2018 | 2019 | 2020 |
| US | 2.9 | 2.3 | 1.6 | 2.4 | 1.8 | 2.1 |
| Eurozone | 1.9 | 1.2 | 0.8 | 1.8 | 1.2 | 1.1 |
| France | 1.7 | 1.2 | 0.9 | 1.9 | 1.1 | 1.2 |
| Germany | 1.5 | 0.6 | 0.5 | 1.7 | 1.4 | 1.5 |
| Japan | 0.3 | 0.9 | 0.5 | 1.0 | 0.5 | 0.6 |
| China | 6.7 | 6.1 | 5.4 | 2.1 | 2.9 | 3.2 |
| India | 7.4 | 4.9 | 5.5 | 3.9 | 3.7 | 4.7 |
| World (2015 PPPs) | 3.6 | 2.8 | 2.8 | 3.2 | 3.2 | 3.2 |

Source: Oxford Economics

# SECTOR FORECASTS

### Food & Drink and Metal Products continue to be the largest manufacturing sectors

Subsector share of Manufacturing Gross Value Added (GVA), Q1 2020




Source: Oxford Economics

## FOOD & DRINK

The **Food & Drink** sector remains the UK's largest manufacturing sector by a significant margin, accounting for 15.6% of total manufacturing GVA. Employment in the sector, at 450,000, is currently its highest since 2004, having grown 2.1% in 2019. However, as we move through 2020, we forecast a drop in employment by 2.4%, negating the expansion seen in 2019 and returning employment to its 2018 level. Although, it has been the subsector that has weathered the political and trade storm of recent years the best, the performance of the sector has predominately been a result of the huge domestic demand. We expect this growth to taper off in 2020, but with strong potential for future growth in 2021.

## ELECTRONICS

**Electronics** has been a positive force for British manufacturing in recent years, with double-digit growth in output in 2018 followed by a strong 2019. However, the forecast for 2020 is less positive with a decline in output of -0.7% predicted. Employment in the sector is predicted to maintain a steady marginal decline by -0.6% over the coming year. High global demand for automation products has driven the sector's recent growth. However, rising competition, particularly from China, has created a tighter market for its products. Recent disruptions to international supply chains stemming from the coronavirus outbreak has meant that some domestic suppliers have benefitted from new orders but other UK firms are experiencing difficulties obtaining semiconductor and other passive components from China for the same reason.

## BASIC METALS AND METAL PRODUCTS

The **Basic Metals**, and by extension the **Metal Products** sector, continues to experience difficult times. Their downstream links to both the Motor Vehicles and Mechanical Equipment sectors, both of which have been experiencing troubling economic conditions themselves, has only compounded the challenges being faced by Basic Metals and Metal Products. The purchase of British Steel by Jingye which we reported on last quarter has finally been completed. Although about 450 workers face losing their jobs, unions have said that the deal should nevertheless be welcomed as it has saved over 3,000 jobs. We expect to see a worsening of output this year by a significant -5.1%. In the most recent data, we have continued to observe an increase in exports to non-EU countries by the **Metal Products** subsector. Exports to the EU are growing marginally. Domestically, the sector is an intermediary between the Basic Metals and both the Motor Vehicles and Mechanical Equipment sectors. The latter two sectors are expected to experience negative economic conditions in 2020, and we expect this to impact the Fabricated Metals subsector as a consequence also. Based on this, we forecast a decrease in output by -2.0% in 2020 for Fabricated Metals.

## MECHANICAL EQUIPMENT

Following a marked contraction in output of -5.3% in 2019, the **Mechanical Equipment** sector looks like it will remain in negative territory, but we expect the rate of decline to slow to -4.5% in 2020. The Mechanical Equipment subsector can often be seen to be a proxy for business investment so the notably low levels of business investment in the UK over the last few years has impacted sales of machinery. However, this quarter's survey indicates that future investment intentions have improved, though any spending will take time to percolate through to business performance in this subsector.

## ELECTRICAL EQUIPMENT

On a related note, **Electrical Equipment** saw growth in both output and employment by 3.8% and 3.7% respectively in 2019. A positive sign from the domestic market, plans for increased reach in network infrastructure across previously disconnected regions in the UK has provided a boost in demand for the subsector's products. However, worries stemming from the threat of the UK's regulatory divergence from EU standards are weighing on the subsector, as standing contracts and new business may be jeopardised by foreign customers seeking to mitigate threats to their supply chain.

### TEXTILES

The **Textiles** industry's better than expected performance throughout 2019 was a result of the artificial boost that stockpiling activities brought about. However, we now see the start of a return to a more normal pattern. We expect a decline in output through 2020 of -2.8%. Skills shortages are a continuing concern in the subsector, threatened further by the potential loss of EU freedom of movement of labour next year. With textiles companies continuing to shift their production overseas, we forecast an acceleration in the -1.5% rate of decline in employment that was witnessed in 2019 to -3.7% for 2020.

### PAPER & PRINTING

The current expectation for the **Paper & Printing** industry is that it will see boosts in demand as a result of the shift away from plastic products. However, these effects are likely to be gradual and more muted in the UK as a continuing global consolidation of paper and printing companies by a few large firms buying out the smaller companies has created a tougher market for UK manufacturers in this industry. The cheap cost of labour in other countries and the relative ease of international transportation of this sector's products has left it particularly exposed to international competitors. As such, following a small expansion in output in 2019, we forecast a decline of -4.3% in 2020. Contributing to this decline will also be weaker demand for the sector's products from the food & drink and the chemicals sectors.

### NON-METALLIC MINERALS

The greatest risk for the **Non-Metallic Minerals** sector (bricks, glass, and mortar) comes from rising costs and subdued investment. As the industry is twice as import intensive than it is export intensive, currency fluctuations are a serious concern for the subsector. Most critically, the limited level of new construction activity in the UK has directly impacted the sector, seeing a massive drop of -5.9% in output in 2019. However, we expect that the worst period has passed, and although our output forecast remains negative for 2020, it is a marked improvement from 2019, standing at -2%.

### PHARMACEUTICALS

The **Pharmaceuticals** subsector comprised some of the largest output boosts in 2019 thanks to stockpiling activities ahead of each Brexit deadline, with many healthcare providers purchasing extra medicines to mitigate any potential disruptions in supply. While these worries have now been somewhat allayed, purchasing has returned closer to baseline levels. We expect a decline in output by -3.1% in 2020 as the business cycle returns to more normal levels.

### CHEMICALS

A pervasive issue that has carried through from 2019 to 2020, the performance of the **Chemicals** sector is heavily dependent on the UK's compliance with the EU's extensive REACH regulation. Industry body the Chemical Industries Association (CIA) has continually highlighted the importance of the REACH regulatory framework for the sector's ability to trade internationally. The subsector's reliance on EU customers poses a risk for the sector if this is not addressed in the future UK-EU trade partnership so we forecast a decline in output by -4.2%.

### RUBBER & PLASTICS

The decline in demand for single-use plastics as a result of growing environmental concerns has been affecting manufacturers in the **Rubber & Plastics** sector, particularly those manufacturers in the packaging industry. The British Plastics Federation (BPF) has also highlighted that 93% of plastic producing firms see the EU as a key market, with a decline in orders from the bloc already impacting producers. The Chancellor announced in the Budget that plastic packaging manufacturers and importers will face a £200 tax per tonne of packaging that has a recycled content of less than 30%. This measure is likely to further impact the sector's prospects. In the UK, tyre manufacturing accounts for a massive proportion of the rubber industry. As the Motor Vehicles sector struggles, so too has the demand for rubber products. We forecast that the -1.9% decline in output that we saw in 2019 will increase even further in 2020, to -3.9%.

## MOTOR VEHICLES

Out of all manufacturing subsectors in the UK, the **Motor Vehicles** sector suffered the steepest decline in output in 2019. New car registrations are down by 7.3% so far this year, reflecting the challenging domestic market the automotive sector is facing. Repeated factory shutdowns last year and turbulent employment figures lay bare the struggles Motor Vehicle manufacturers are facing to maintain competitiveness in the market. However on a positive note, according to The Society of Motor Manufacturers & Traders (SMMT), alternative fuel vehicle sales are up significantly this year. While this innovation in the automotive manufacturing market is a good sign for the future, the overall market share for alternative fuel vehicles remains small. We forecast the automotive sector will face a very marginal decrease in output for 2020 by -0.4% as its valued-added output variation ‘bottoms out’ following the large drops it saw due to repeated emergency Brexit related shutdowns in 2019.

## OTHER TRANSPORT

Primarily composed of defence, aerospace and shipping industries, the **Other Transport** sector remains quite resilient to short term national economic fluctuations by virtue of its secure and time committed order books. Nevertheless, it is exposed to long term trends in the economy and, critically, to international regulations. The reduced influence from UK aerospace manufacturers as a result of our EU departure has the potential to reduce the competitiveness of UK products in the European market. As these impacts are likely to take time to be felt, we forecast growth in output for the other transport sector by a small 1% this year.

### Sector growth rates and forecasts

% change

| | OUTPUT | | | EMPLOYMENT | | |
|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2019 | 2020 | 2021 |
| Basic metals | -3.5 | -5.1 | -0.8 | 1.4 | 0.2 | -0.6 |
| Metal products | 0.1 | -2.0 | 0.2 | 3.1 | -1.4 | -0.3 |
| Mechanical | -5.3 | -4.5 | 0.6 | 2.5 | -0.4 | -0.7 |
| Electronics | 2.4 | -0.7 | 1.9 | -0.6 | -0.6 | -1.1 |
| Electrical | 3.8 | -2.9 | 0.8 | 3.7 | -2.8 | -2.4 |
| Motor Vehicles | -7.1 | -0.4 | 3.8 | 3.1 | -5.0 | -1.9 |
| Other transport | -1.2 | 1.0 | 2.0 | 0.8 | -3.1 | -1.6 |
| Food and drink | 2.4 | -0.1 | 1.8 | 2.1 | -2.4 | -0.9 |
| Chemicals | -0.5 | -4.2 | 0.7 | 3.4 | -5.2 | -3.8 |
| Pharma | 4.2 | -3.1 | 1.9 | 1.0 | -3.9 | -4.6 |
| Rubber and plastics | -1.9 | -3.9 | 0.3 | -1.8 | 13.6 | 1.1 |
| Non-metallic minerals | -5.9 | -2.0 | 0.0 | 3.7 | -3.0 | -1.5 |
| Paper and printing | 1.2 | -4.3 | -1.3 | -2.5 | -5.8 | -2.8 |
| Textiles | 1.3 | -2.8 | -2.9 | -1.5 | -3.7 | -4.5 |
| Manufacturing | -1.5 | -2.1 | 1.1 | 0.4 | -1.2 | -1.3 |

Source: Make UK and Oxford Economics

Source: Oxford Economics

# BDO VIEWPOINT

## MANUFACTURING IN A CHANGING WORLD

Manufacturing remains one of the most important sectors in the UK economy, continuing to make significant contributions to research and development, employment and productivity growth – and providing a vital source of competitiveness. Our Q1 Manufacturing Outlook survey results demonstrate the sector's resilience, with both confidence and investment intentions improving this quarter. However, it is worth noting that the survey was completed before the onset of coronavirus in China and the rest of the world. We're conscious the results this quarter present the position and sentiment at the date of the survey, which may have shifted more recently.

As we enter a new decade, manufacturers will no doubt face new challenges but there are three areas which I believe need to be firmly at the top of manufacturers' agenda.

## GREEN IS THE NEW BLACK

Growing public pressure and increasing regulation mean the move towards a lower carbon footprint will be one of the major factors in manufacturing now and in the decades to come. Manufacturers must strive for greener and more sustainable processes, technologies and materials to meet growing consumer demands and environmental concerns.

We are already seeing global OEMs issuing public statements that they have recognised this challenge and are expecting their supply chains to develop sustainability programmes to meet that agenda. The direction of travel is all too clear – sustainability will rapidly become a 'must have' for all manufacturers.

## DIGITAL TRANSFORMATION AND TECHNOLOGICAL DISRUPTION

4IR and digitalisation are fundamentally changing the way manufacturers operate, communicate and manufacture goods. It provides manufacturers with a unique opportunity to add real value to their business, their customer and their supply chain.

Cutting-edge technologies like artificial intelligence, robotic process automation or 3D printing might seem like distant dreams for manufacturers that are still focused on migrating to the cloud or just dipping their toes into shop-floor automation. However, manufacturers in competing countries are investing heavily. Stagnation is a death knell in today's manufacturing environment.

The pace of technological change is incredible. Those that embrace digital transformation and new technologies can truly benefit and gain significant competitive advantage.

## GLOBALISATION

The last 40 years could be characterised as the globalisation of the world economy – in part driven by the search for lower costs and increased profits – and now most OEM supply chains are global and highly integrated.

Growing global competition means that UK manufacturers must be increasingly international in their approach – even more so now that the UK has left the EU. The larger population countries will continue to build their own manufacturing sectors and rapidly developing/developed countries like China and India are likely to become a force on the global stage. But, as noted above, it will be interesting to see if the impacts of the coronavirus have a lasting and damaging impact on the China-connected supply chain in particular.

Change offers huge opportunities and, if properly supported, Britain's historic strengths in innovation, design and service provide the right foundations for a successful and well balanced UK economy. There is no doubt that the sector needs the government to develop a clear and supportive industrial strategy to help support the significant change and high levels of investment that will be required.

**Tom Lawton**
Partner and Head,
BDO Manufacturing
0121 352 6372
tom.lawton@bdo.co.uk

Make UK works for the success of more than 2.7 million men and women employed in UK manufacturing. Representing member companies – from small businesses to multinationals – across every industrial sector, we are the most influential voice of manufacturing, enabling our members to connect share and create opportunities together.

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**

To find out more about this report, contact:

**Fhaheen Khan**
Economist
fkhan@MakeUK.org

**James Brougham**
Economist
jbrougham@Makeuk.org

**Seamus Nevin**
Chief Economist
snevin@Makeuk.org

**Make UK Information Line**
0808 168 5874
research@Makeuk.org

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

*Correction: Manufacturing Outlook 2019 Q3 reported a confidence value of 5.8 this should have been 3.4.

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

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Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,800 offices in 167 countries. We operate from 17 offices across the UK, employing 5,150 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:

**Tom Lawton**
Head, BDO Manufacturing
0121 352 6372
tom.lawton@bdo.co.uk

**Baljit Bhamra**
Marketing and Business Development Manager – BDO Manufacturing
0121 352 6296
baljit.bhamra@bdo.co.uk

The Manufacturers' Organisation

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