28/02/22

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MAKE UK MANUFACTURING MONITOR

#BackingManufacturing

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Key findings

60% of companies say the National Insurance rise will have a moderate or significant impact on recruitment

39% of manufacturers state they are already pricing-in energy costs into their final product

72% of companies say they will certainly or likely pass the costs of the National insurance hike onto customers

49% think it will take over a year for energy prices to settle, with 23% expecting their costs not to settle for at least two years.

47% of businesses have adjusted business practices in the face of soaring energy costs

57% of manufacturers have seen an increase in retirement or reduced hours in the wake of the pandemic.

Introduction

This is Make UK's first edition of Manufacturing Monitor in 2022, an adaptive report based on the most pressing issues for UK manufacturers at the time of publication. Its inception as a regular publication came in response to the pandemic, where fast-moving intelligence was required to best understand the challenges the industry was facing on a month-to-month basis, capturing and presenting issues that could not be properly elicited by medium to long term outlook reporting.

This first edition of the year comes at a critical time for manufacturing in the UK, a juxtaposition between soaring domestic and international demand for British manufactured goods and extreme supply-side limitations that are seeing manufacturers struggle to maintain production capacity. Following approximately two years of economic suppression, it's now, in this so-called recovery period, that UK manufacturers are eager to make the most of their swelling order books to recoup as much of the lost value as possible.

As almost all pandemic-related Government support is progressively withdrawn from the industry, and even with a new prospective hurdle erected by way of the planned National Insurance hike, manufacturers are enduring a cash and margins squeeze beyond anything they've faced in the past decade, let alone the last two years.

This edition of Manufacturing Monitor will detail, in brief, the most pressing challenges to UK manufacturers' operations at the point of publication, covering topics on costs, investment, employment and customs.

The National Insurance increase

The planned National Insurance Contributions (NICs) hike comes at an astoundingly inopportune time for UK manufacturing, not least because it will add to what are already soaring costs for UK businesses, but it will directly work against manufacturers' efforts to secure labour in the industry during an unprecedented shortage of workers.

60% OF COMPANIES SAY THE NATIONAL INSURANCE RISE WILL HAVE A MODERATE OR SIGNIFICANT IMPACT ON RECRUITMENT.

The planned NICs rise stands to be an anchor on growth for the sector, as it will further worsen one of the most significant challenges manufacturers are facing in their business at the moment: the shortage of labour. It's this inability to fill roles reliably that is leading to the industry's inability to fulfil their booming order books, in turn leaving individual manufacturers 'missing out' on maximising their potential during the post-pandemic recovery period.

Make UK is calling for the planned NICs rise to be postponed until the economy is in a more robust position, a position where such a significant change such as this wouldn't stand to threaten what is an already fragile economic recovery. We believe that the public purse should be recouped not through means of taxing the supply-side during a supply crisis, and instead, should focus on means of recovering the purse through growth.

Further to the potential damage to manufacturing's recovery, the inflationary implications to the wider economy are significant. While input inflation is soaring, consumer inflation is rising at a concerning pace too.

If this NICs rise comes to pass, the majority of manufacturers indicate that they are likely to pass this cost directly onto customers, further fuelling the inflationary fire that will continue to trickle down into the consumer economy.

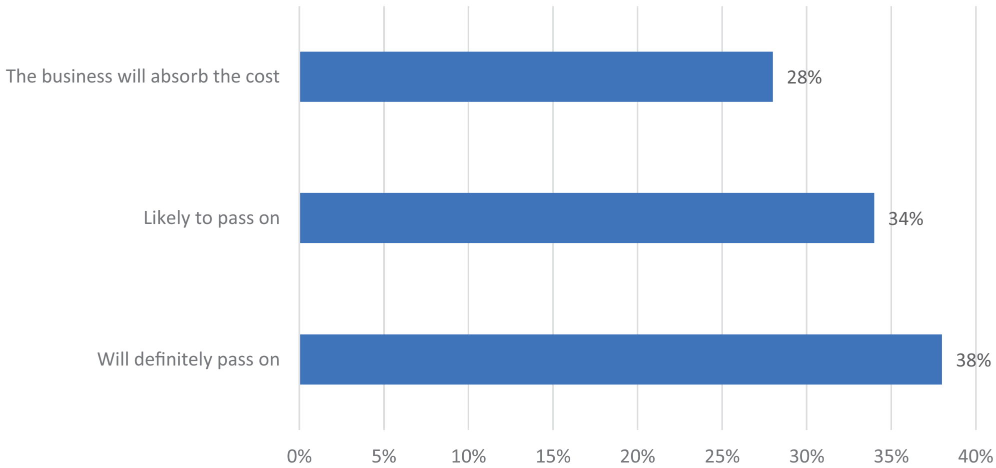


Chart 1: Manufacturers indicate that the majority of the industry will be passing any NICs rise straight through onto customers

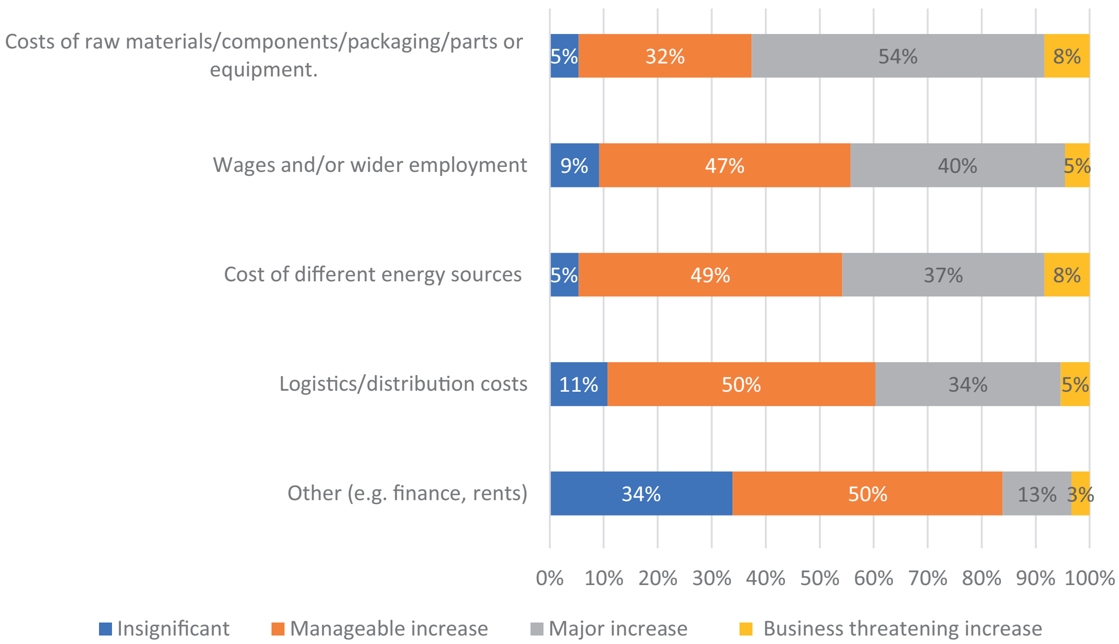
Source: Make UK Manufacturing Monitor February 2022

The soaring cost of doing business

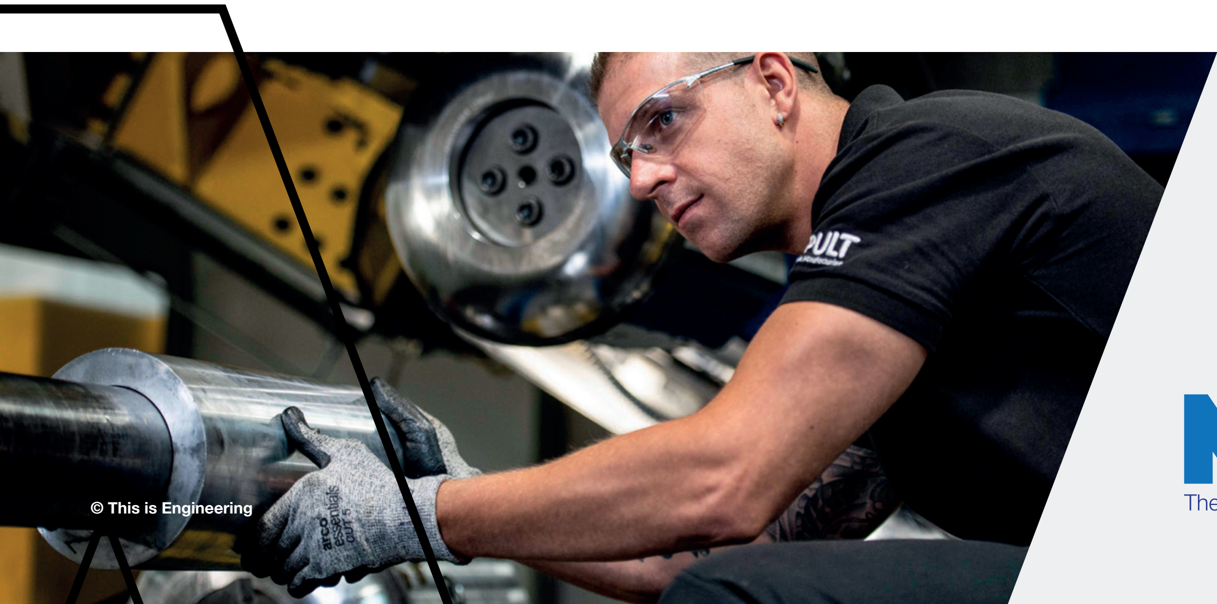
Manufacturing input prices, on aggregate, have been climbing since April of 2020, and have continually soared since December of the same year. Currently, as the latest ONS Producer Price Inflation data shows, the headline rate of input prices showed positive growth of 13.6% on the year to January 2022. While Manufacturers are also raising their factory gate prices, in other words, the prices of their finished goods, at an alarming rate, it's proving to be insufficient to offset the erosion to their operating margins.

The most pressing cost challenge to manufacturers comes in the form of material costs, with 54% saying that they are facing a major increase, even now two months into the new year. What's of even further concern, is that 8% of the industry suggest that these material increases are so significant that they are an existential threat to the business.

Chart 2: Hierarchy of severity of cost increase to manufacturers in February 2022



Source: Make UK Manufacturing Monitor February 2022



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However, material costs are just one of the facets of the costs tidal wave the industry is facing, with energy and labour cost challenges following in quick succession. Wage inflation in the industry has been significant and shows no signs of cooling in the immediate future. Larger trade unions are negotiating with employers for group settlements as high as 7% for their workforce, using the exceptionally high forecasts for retail price inflation (~7%) as a basis.

Vacancies within the industry are at a time-series high, with the highest manufacturing vacancies per 100 employed for twenty years reported by the ONS's latest employment figures. The current rate of vacancies in the industry stands at 4.0 roles per 100 employed. By way of comparison, the average figure across that same twenty-year time period is only 1.9, demonstrating just how short for labour the manufacturing sector is at the moment.

There is a multitude of factors that are exacerbating the challenges manufacturers are facing when it comes to accessing labour, with the leading issues being: increased difficulty sourcing labour from the EU following the UK's exit from the Bloc, an expensive labour market, changing workforce attitudes towards flexible working, and reduced hours or early retirement.

While the all-UK economy vacancy rate has also grown significantly between March 2020 and now, by approximately 65%, the manufacturing vacancy rate has grown by a staggering 91% in that same period, highlighting the unique challenge manufacturing businesses face for what is typically on-site labour, even despite the manufacturing industry offering 12% higher wages on average than the wider economy.

57% OF MANUFACTURERS HAVE SEEN AN INCREASE IN RETIREMENT OR REDUCED HOURS IN THE WAKE OF THE PANDEMIC.


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Further compounding the issue of labour shortage, manufacturers are seeing their existing staff either work reduced hours, or take early retirement, following the pandemic. 57% of the industry has reported dealing with this issue in some capacity in their business.

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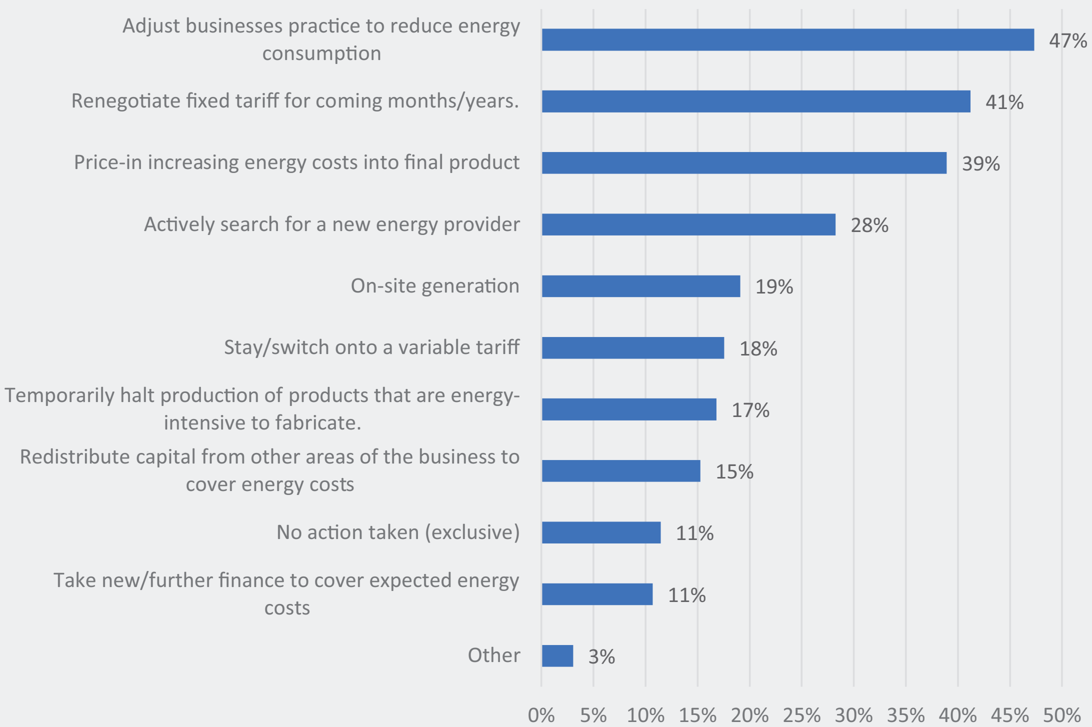
Assault from left field: Energy Costs

Manufacturers had been grappling with the successive increase in both labour and material costs for at least the past two quarters, which had both been gaining momentum since the start of the post-pandemic recovery period approximately half a year ago. What has caught many businesses off guard now in the new year, is the sudden and significant increase in energy prices they are having to fund. This challenge is particularly pronounced for those manufacturing businesses that are energy-intensive in their production.

While energy prices had been increasing in the background for a little while before the turn of the year, for many in the industry, their first exposure to these new heightened costs came when their current energy contracts expired, and the time came for renegotiation.

As part of this edition's fieldwork, we wanted to understand what practical steps the industry had taken in response to this energy cost inflation:

Chart 3: Actions manufacturers have taken in response to heightened energy prices in 2022



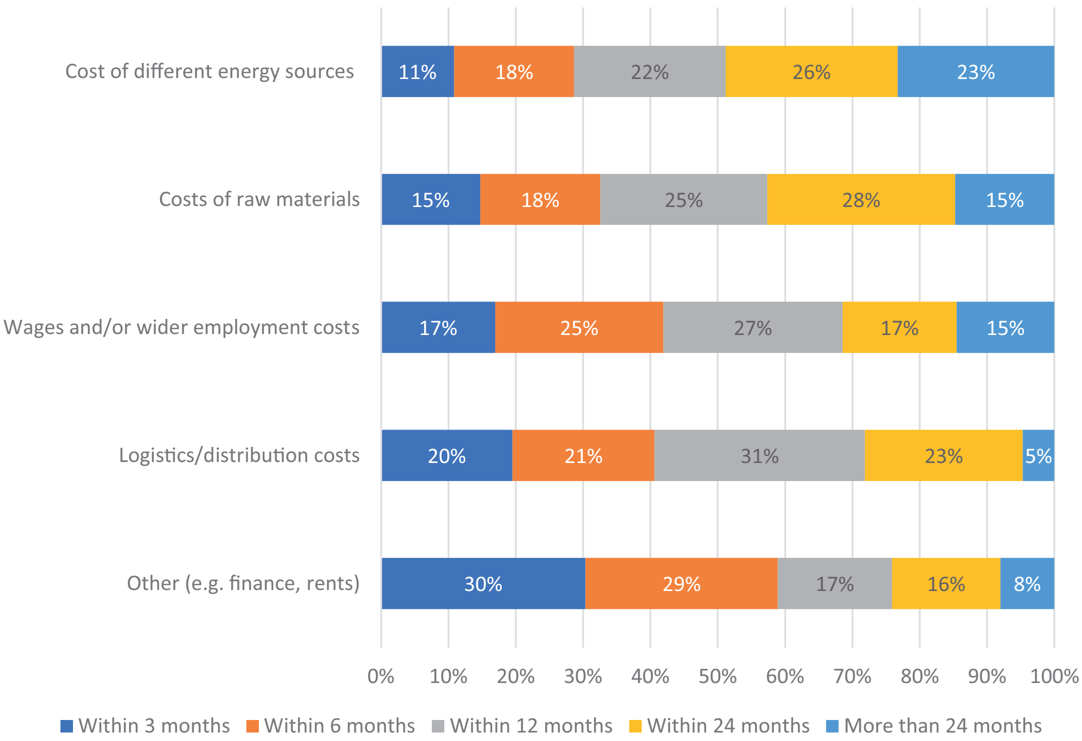
Source: Make UK Manufacturing Monitor February 2022

With the strength of the industry's order books, manufacturers are motivated to continue production at as high of a pace as possible, but the industry won't be able to sustain output growth if heightened input prices are sustained in the long term.

When the first signals of significant post-pandemic input price inflation were emerging, both analysts, industry, and indeed the Bank of England itself expected these pressures to be transitory, perhaps only lasting 6 months in the first instance. Now, approximately 10 months later, expectation horizons on when this inflationary boom will cool have been widely extended. 49% of manufacturers think it will take over a year for energy prices to settle, with 23% expecting their costs not to settle for at least two years. This is a worrying outlook for the sector's input energy prices, fuelled by pessimism within the sector that the UK economy is set for an endured assault on their energy costs.

Unfortunately, the same pessimism is observed across other business costs, as businesses continue to push back their expectations as to when their input costs will return to normality. 43% of businesses expect material cost inflation to take over a year to settle, with a further 15% expecting it to take at least two years.

Chart 4: Time expectations for when manufacturers expect various cost pressures will return to baseline inflation



Source: Make UK Manufacturing Monitor February 2022

Some comparative optimism is seen in the expectations for logistics costs, with only 5% expecting it to take more than two years for these costs to return to normality.

'Super Deduction' and Investment

At the time of the Chancellor's Super Deduction announcement, a pro-business investment policy that saw a new 130% first-year capital allowance for qualifying plant and machinery assets; and a 50% first-year allowance for qualifying special rate assets, the manufacturing industry's reception of the policy was more nuanced than expected. A few weeks after its announcement, Make UK researched the sector's attitude towards the policy.

In the wake of the budget announcement at the time, 77% of the industry said their business confidence was unchanged, 20% improved, and only 3% unchanged.

Out of all major announcements at the time, businesses identified super deduction as having the most positive potential impact on their businesses (58%), (out of JRS extension (42%), apprentice incentives (13%), R&D tax credit increase (38%), Free Ports (14%), RLS (4%), Help to Grow (11%)) – Percentages exceed 100 as from multiple choice of pick two.

Regarding planned use of the scheme, approximately 50% said Super Deduction will have no impact on their investment plans. Of those do did intend to use it, 23% said they will be increasing their total level of investment, and 28% said they would bring forward their already existing investment plans to take advantage of the scheme.

Those businesses who have not, or intended not to use the scheme commonly cite some or all of the following reasons as to why:

- Exclusion of leasing
- Exclusion of used/second-hand
- Investment plans are too rigid
- Lack of investment capital/ low spare capital due to Covid
- Lack of confidence/ do not want to commit capital during the pandemic

We often found that companies in the SME category would more commonly cite the leasing and used exclusions, as it follows that this segment of the industry would be more likely to acquire capital goods by one or both of these processes.

In this edition of Manufacturing Monitor, as the scheme is approximately halfway through its lifecycle, we elicited how much investment manufacturers had made using the 'Super Deduction scheme. The median value reported to us was 228,500, with the mean value being significantly larger as the data is skewed by some large companies making significantly larger investments.

THE MEDIAN FIGURE MANUFACTURERS INVESTED USING THE SUPER DEDUCTION SCHEME WAS £228,500 AS OF FEBRUARY 2022

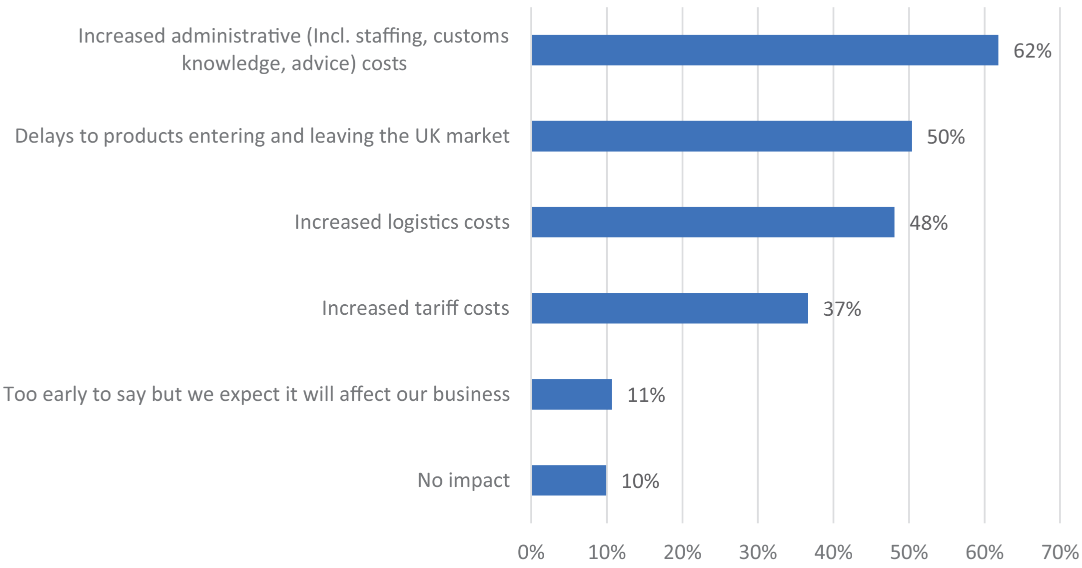
Make UK continues to recommend that the Super Deduction policy is re-announced with a significant extension, so that industry can effectively plan investment in the medium to long term, moving it away from a short-term Covid intervention policy. The industry has become increasingly cautious over the last two years of spending capital, especially given the continued input price pressures the sector is facing, and will likely continue to face, for the rest of 2022. Policies, such as the Super Deduction, can be reformed as a longer-term scheme to bolster investment, and subsequently confidence, beyond the immediate future.

Other tweaks to the scheme are also recommended, particularly concerning the leasing and used exclusions in the policy, as these exclusions disproportionately affect smaller sized businesses.

Customs: the second coming

It's no secret that the industry had to adapt significantly last year in the wake of the new trading relationship between the UK and EU. Now, a year later from that point, we surveyed to elicit how the phasing in of import controls is affecting manufacturers' operations, particularly when set against the backdrop of the current supply chain challenges.

Chart 5: Manufacturers reveal what impact the new customs rules as of the 1st Jan 2022 have had on their operations



Source: Make UK Manufacturing Monitor February 2022

While the increased administrative accosts associated with these new controls takes the top position as the most impactful, with 62% of the industry enduring the added cost, perhaps the most concerning consequence of these new controls is the delay to products entering and leaving the UK market (50%), given extended product lead time and inability to secure supply are the chief factors limiting manufacturers' ability to maintain output growth presently.

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Appendix

Survey details, key questions and % share of respondents
Sample: 132
Survey Period: 02/02/22 – 23/02/22

With the rising prices in the energy market, what action, if any, has your business taken? (Select all that apply)	
Other	3%
Take new/further finance to cover expected energy costs	11%
No action taken (exclusive)	11%
Redistribute capital from other areas of the business to cover energy costs	15%
Temporarily halt production of products that are energy-intensive to fabricate	17%
Stay/switch onto a variable tariff	18%
On-site generation	19%
Actively search for a new energy provider	28%
Price-in increasing energy costs into final product	39%
Renegotiate fixed tariff for coming months/years	41%
Adjust businesses practice to reduce energy consumption	47%

How immediate and severe are the cost pressures facing your businesses? (select one per row)

	Insignificant	Manageable increase	Major increase	Business threatening increase
Other (e.g. finance, rents)	34%	50%	13%	3%
Logistics/distribution costs	11%	50%	34%	5%
Cost of different energy sources	5%	49%	37%	8%
Wages and/or wider employment	9%	47%	40%	5%
Costs of raw materials/ components/packaging/ parts or equipment.	5%	32%	54%	8%

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When do you think these will resolve for your business? (select one per row)					
	Within 3 months	Within 6 months	Within 12 months	Within 24 months	More than 24 months
Other (e.g. finance, rents)	30%	29%	17%	16%	8%
Logistics/distribution costs	20%	21%	31%	23%	5%
Wages and/or wider employment costs	17%	25%	27%	17%	15%
Costs of raw materials	15%	18%	25%	28%	15%
Cost of different energy sources	11%	18%	22%	26%	23%

How much investment has (or will) your business made using the Super Deduction scheme?	
Median	228,500

To what extent have you seen an increase in early retirement or reduced hours following the pandemic? (select one)	
Haven't seen/ No evidence	43%
Slightly more than usual	30%
Moderately more than usual	20%
Large increase over usual	7%

What impact, if any, have the the new customs rules (1 Jan 2022) had on your business? (Select all that apply)	
No impact	10%
Too early to say but we expect it will affect our business	11%
Increased tariff costs	37%
Increased logistics costs	48%
Delays to products entering and leaving the UK market	50%
Increased administrative (Incl. staffing, customs knowledge, advice) costs	62%

Is the forthcoming increase in National Insurance Contributions (NICs) likely to impact on your recruitment plans? (select one)	
Yes it will significantly impact recruitment	27%
Yes, it will moderately impact recruit	33%
No, it will have no impact	40%

How likely are you to pass the cost of the NICs rise onto your customers? (select one)	
Will definitely pass on	38%
Likely to pass on	34%
The business will absorb the cost	29%

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The results of the first Make UK Manufacturing Monitor of 2022 provide unique insight relevant to the current economic environment, covering several elements including the impact of escalating costs, the impact of an unstable energy market, Government investment policy, National Insurance increases and the implications of new customs checks.

For more information please contact:

James Brougham
Senior Economist
jbrougham@makeuk.org

About Make 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 means we're able to influence policymaking at local, national and international levels. We push for the policy changes that our members want to see. We are the voice of manufacturing.

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www.linkedin.com/company/makeuk

Make UK General Enquiries
0808 168 5874
makeuk.org

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