In partnership with:

BDO IDEAS | PEOPLE | TRUST

MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2021 QUARTER 2

With support from:

Scottish Engineering and Manufacturing NI

FOREWORD

Stephen Phipson CBE
Chief Executive
Make UK

Richard Austin
Head of Manufacturing
BDO LLP

Exactly one year on from the publication of *Manufacturing Outlook's* worst results in the survey's history, the mood music has changed dramatically. In what has recently been a dejected patter of quarters for the industry, manufacturers are now finally able to look to the future with earnest confidence. The industry is certainly not without its challenges, both ongoing and new, but the sector has now demonstrated that it can generate growth despite the still perilous circumstance.

While the industry gets back to work at an unprecedented pace, it does so now more keenly aware, and prepared, to mitigate the impacts of the trials that the rest of the year has poised to test it with. These trials, which are by no means mutually exclusive, form the basis for somewhat of a triple-threat to the sustainability of the recovery that is being exhibited within the manufacturing sector in this second quarter.

The first of these antagonising musketeers comes in the form of the novel Trade Cooperation Agreement (TCA) between the UK and the EU. The onus of new protocols and paperwork wreaked havoc for British exporters in the first quarter of the year, reflected in the 40% drop in exports to the EU in January. Since then, businesses have overcome many of the hurdles imposed on them by this new arrangement, with this report detailing significant export improvements compared to the start of the year. Nevertheless, snagging issues continue to emerge with customers and partners in the EU which hamper the speed of trade recovery for the sector.

The second dampener to the industry's recovery is the ongoing uncertainty generated by unpredictable COVID-19 regulations both here and abroad. While the UK has come leaps and bounds in recent months in terms of the economy reopening, many events critical to the prosperity of UK manufacturing, such as trade shows, struggle to go ahead. This is particularly pronounced in the case of international business travel, where companies and delegates must worry not only about the viability of an event, but also must endure the mercurial travel and quarantine regulations both domestically and abroad.

The third, and perhaps the most prolific of challenges facing the sector lies in supply-chain disruptions. As the international business community enjoys a sudden spike in demand as the economy has sped up faster than expected, so too the strain on these already delicate supply-chains increases. Of course, just prior to this demand spike supply-chains were already significantly stressed owing to COVID-19 related pressures, but now with demand outstripping supply, or rather, the ability to supply in many cases, UK manufacturers are finding that they cannot affordably source inputs for their product, or cannot source inputs at any rate. Supplier delivery lead times are floating at an all-time high, container shipping prices are ballooning, and core inputs are seeing waning availability.

However, despite these obstacles, the manufacturing sector has set off the starting blocks of recovery. The trajectory of which is encouraging, with performance outpacing expectations for the first half of the year. Confidence within the sector is soaring, fuelled by orders and demand across the industry which has been long-missed since the start of the pandemic. Much needed investment expenditure is set to be rendered and employment within the sector looks to expand. The industry is confident that it will be able to overcome the obstacles put before it in the coming year, now equipped with the crisis management ability that it was forced to learn under duress at the inception of the pandemic. It's with these lessons learned that the sector now has the opportunity before it to build back better, with business resilience and sustainability at its core.

HEADLINES

Make UK's Q2 2021 *Manufacturing Outlook* report, in partnership with BDO, highlights the activities of UK manufacturers exactly one year on from the record-breaking lows reported in Q2 2020.

Following those sharp declines, at -56% and -53% for output and orders respectively, manufacturers have been rebuilding, restarting, and reopening slowly. Of course, the staggered approach to pandemic restrictions increasing and decreasing in severity created barriers for a sector eager to get back to work. Alongside this, the introduction of the Trade Cooperation Agreement (TCA) with the EU led to a series of trade barriers that saw exports decline significantly at the start of the year.

The latest figures for many of our metrics indicate the growth reported last quarter has continued and accelerated in a manner of speaking. The sharp "bounce back" was anticipated given its pandemic-induced nature with pent-up demand taking hold. However, we must be cautious not to embrace this growth as a true expansion of the sector given the low base it is starting from. Indeed, the growth reported this quarter is not as high as the lows reported last year.

As the UK prepares to fully reopen its economy, the latest figures reported manufacturing output levels at a record high. At 36% the result indicates that the largest share of manufacturers ever has experienced an improvement in output levels, relative to those that have reported a decrease. Looking forward manufacturers expect to break this record again forecasting the output balance to reach 46% in Q3.

After turning positive for the first time since Q2 2019, the UK order balances have continued to expand, reporting at 27% – the highest on record. The domestic market has always been a significant concern for manufacturers which historically has not performed as well as its international counterpart, export orders. The export order balance has come in at 22%, while not record-breaking it is an uplifting change in international sales following the difficulties faced from the UK's exit from the European Union (EU).

Amid rising cost pressures, selling prices have expanded for most manufacturers, reporting at 36% and 31% on balance for UK and export prices respectively. To avoid price rises passing through supply-chains too quickly manufacturers continue to take a hit on margins, although UK margins have improved on its Q1 figures. Margins are the only metrics to remain negative on balance but are forecast to turn positive in Q3, indicating manufacturers expect the concerns around cost pressures to be temporary.

As the Job Retention Scheme (JRS) comes to an end in a few months, the latest data indicates manufacturers have had a head-start in hiring/re-hiring workers to manage the sharp rise in workload. Investment intentions have also improved this quarter, likely impacted by the Government's super-deduction policy resulting in many manufacturers bringing future investments forward to take advantage of the 130% tax benefit.

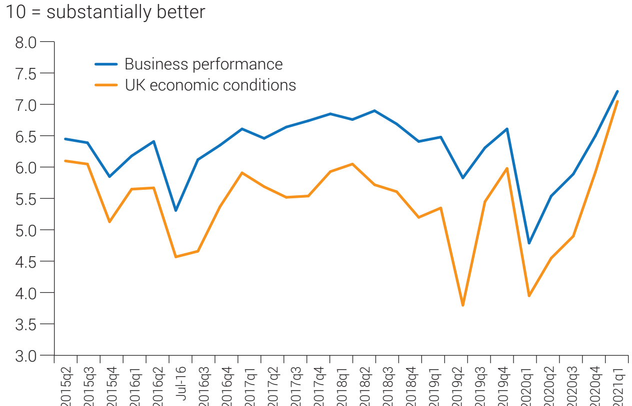
INDICATOR	BALANCE	CHANGE	
Confidence	7.2	↑	Business confidence reaches its highest level since 2014
Output	36%	↑	Output balance highest on record
UK orders	27%	↑	UK orders balance highest on record
Export orders	22%	↑	Export orders improve substantially following 4 quarters of decline
Employment	20%	↑	Jobs improve for the first time since Q1 2020
Investment	17%	↑	Investment intentions turn positive for the first time since Q1 2020

Source: Make UK Manufacturing Outlook Survey

Both business and economic confidence have achieved record highs since data collection for this metric began in Q3 2014. The result is fuelled by the reopening of the economy, new work returning to manufactures and the prospect of returning to normal life.

Confidence levels reach a new peak

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

In the second quarter of this year, Make UK's *Manufacturing Outlook* research has recorded the highest quarterly balance figures for output in the survey's history. Total output has ballooned even beyond the positive future expectations for output reported by manufacturers in the first quarter. Following last year's consistently negative output figures during the height of the pandemic in the UK, it was expected that there would be a significant bounce-back in output volumes in 2021, however, it was expected that this degree of positivity would only emerge in the second half of the year. Given the triple-threat of the circumstance manufacturers find themselves in, namely, the novel TCA, supply-chain issues, and ongoing COVID-19 challenges, the demonstrable positivity in output seen already in the first half of the year is an encouraging sign for the sector's trajectory for the rest of the year.

PAST THREE MONTHS	↑	36%	NEXT THREE MONTHS	↑	46%

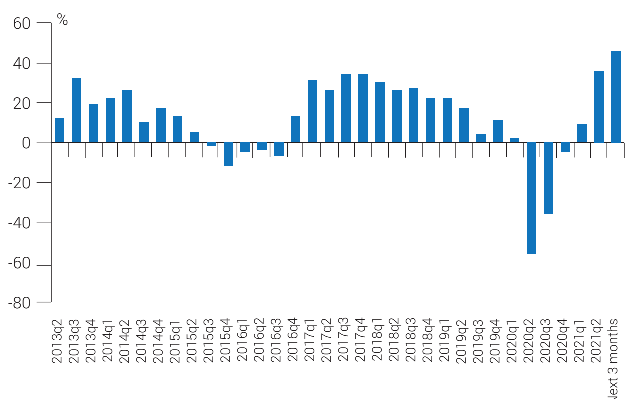
While a positive output balance figure of 36% is a survey record in its own right, what's even more revealing of the industry's recovery are respondent's expectations for output performance in the 3rd quarter of the year, which expect an exceptionally positive balance figure of 46%.

Nevertheless, while these positive figures and future optimism will be welcomed in the sector, they must be contrasted against dire negativity that the industry endured in the last year, the worst of which in *Manufacturing Outlook's* research came in the second quarter of 2020, reporting a balance figure for output of -56% at the time. While the industry is certainly taking steps in the right direction, it will require consistent quarters of positivity to make headway on recouping the real value lost in output throughout 2020.

Looking at this quarter's output results by company size we can see that all sizes of manufacturing business enjoyed strong positive output performance, although it is clear that larger companies saw their output expand in the second quarter faster than that of those in the £0-9m turnover band. That trend is expected to continue into the third quarter of the year, but the gap in output growth expectation between smaller and larger companies is expected to be less pronounced. This was to be expected given the extra wind-up time often required in companies on the smaller end of the scale, as they often have less resource to deal with novel circumstances in the short term.

Output balance improves sharply one year on

% 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	10%	0%
Metal Products	45%	41%
Mechanical	40%	45%
Electronics	50%	53%
Electrical	25%	42%
Rubber & Plastics	0%	25%
TURNOVER		
£0-9m	23%	35%
£10-24m	54%	45%
£25m and over	42%	58%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The latest *Manufacturing Outlook* Survey for Q2 2021 indicates overall orders increased for manufacturers in the last 3 months. However, it is too early to tell whether the significantly positive figures reported below represent new growth or expected growth due to the sector starting from a lower base.

The survey reports that a balance of 34% of manufacturers have reported an increase in total orders over the last three months, this is up substantially from a 9% balance last quarter and is the 2nd highest total order balance on record.

UK ORDERS	PAST THREE MONTHS	↑	27%	NEXT THREE MONTHS	↑	36%
EXPORT ORDERS	PAST THREE MONTHS	↑	22%	NEXT THREE MONTHS	↑	33%
TOTAL ORDERS	PAST THREE MONTHS	↑	34%	NEXT THREE MONTHS	↑	42%

The figure highlights the continuation of reopenings for manufacturers across the nation that began earlier this year, but at an accelerated rate as we approach an almost-complete reopening of the economy. Nevertheless, manufacturers will be acutely aware of the ongoing risks of returning to lockdowns should vaccinations not be as effective as hoped.

The 34% order balance reported is double what manufacturers forecasted in the previous survey for Q2, suggesting the bounce back has been more vigorous than expected. Looking at the next quarter, manufacturers expect orders to continue to improve domestically and internationally. These forecasts give reason to be optimistic but a feeling of cautiousness will linger due to the stop-start nature of the UK economy over the past year.

For instance, the impact of leaving the EU on trade continues to disrupt manufacturers across all industries, particularly for those that rely on EU based inputs. Recent trade statistics from the ONS suggest the trade deficit has narrowed by a substantial £8.4bn in the first quarter this year. Although this can appear quite positive, it is possible this is a reflection of importing challenges outweighing exporting challenges.

UK ORDERS

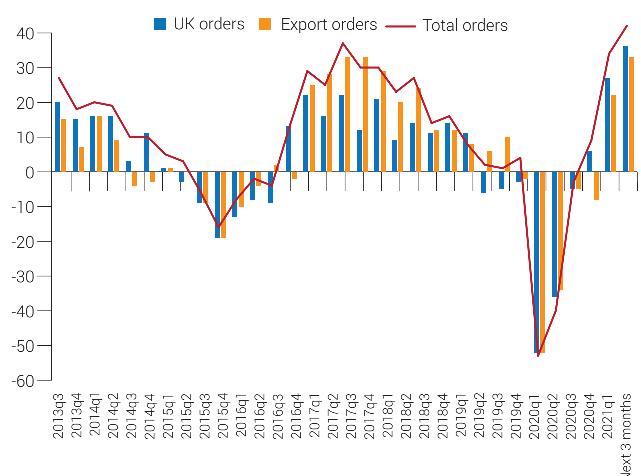
The UK orders balance improved to 27% this quarter, the result indicates on balance a larger share of manufacturers saw an increase in domestic orders relative to those that saw a fall. It is a strong improvement on last quarter's 6% balance and the highest reported in the survey's history.

Previously the data suggested that an increase in consumption combined with a partial substitution of supply-chains, from overseas to reshoring, may explain this sudden improvement in domestic orders. As it stands it's not possible to confirm this without further evidence but given the severity of the impact leaving the EU has had on UK manufacturers it would not be out of the question for firms to consider alternative routes to sourcing inputs.

A subsector view of UK orders activity indicates all major intermediate industries reported greater levels of new work in the last three months. Basic Metals reported a positive

Orders expand across the board as markets reopen

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

30% balance following a poor -45% last quarter. Similarly, the UK orders balance for Metal Products also indicates expansion. Nevertheless, both sectors should be wary of difficulties faced by Liberty Steel, which may impact the Basic Metal and Metal Product supply-chains, this may include shortages in key metals or higher steel prices that impact downstream firms.

The only intermediate industry not to report very positive figures is the Electrical Equipment subsector, where a 0% indicates an equal share of firms have seen improving domestic orders as those that have seen a worsening performance in the last three months.

EXPORT ORDERS

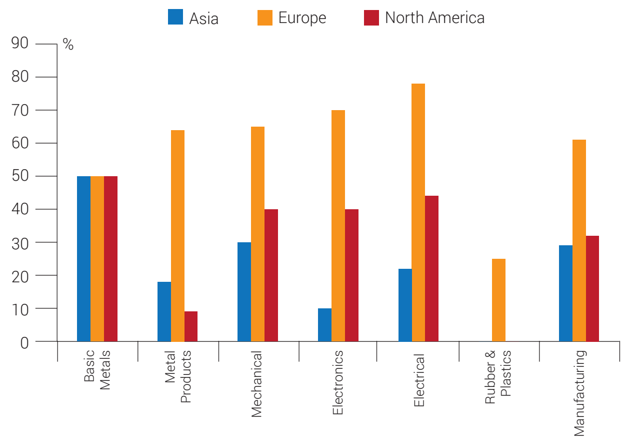
Export orders reported a balance of 22%, a sharp return to positivity on last quarter's -8%.

The strong pick up for export orders is likely explained by the steep declines witnessed immediately after the transition period ended. This fall in orders is best explained by orders either being artificially pushed back to allow breathing room for manufacturers to assess the new trading environment as well as shipping delays, higher logistic costs and red tape which prevented the movement of goods in the early days. Now many of these orders have been able to proceed resulting in the higher export order balance. As manufacturers adjust to the new trading environment it is expected overseas orders will continue to increase – this is also forecasted by manufacturers who expect a balance of 33% for export orders in Q3 2021.

After six months, manufacturers continue to report positive demand conditions in the EU, despite increased trade restrictions that have made exporting and importing a more laborious process. This is likely due to manufacturers not being able to easily substitute UK-EU supply-chains. Nevertheless, demand conditions appear to be improving elsewhere too as more firms report better conditions in both North America and Asia too.

Demand conditions improve for most intermediate subsectors

% 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%	10%	-44%	-33%	30%	10%
Metal Products	32%	36%	-13%	6%	32%	32%
Mechanical	34%	45%	32%	48%	40%	53%
Electronics	16%	11%	44%	22%	45%	25%
Electrical	0%	42%	17%	33%	17%	25%
Rubber & Plastics	25%	25%	-50%	0%	0%	25%
TURNOVER						
£0-9m	21%	34%	-6%	16%	23%	34%
£10-24m	38%	35%	19%	28%	46%	36%
£25m and over	47%	41%	56%	49%	49%	51%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

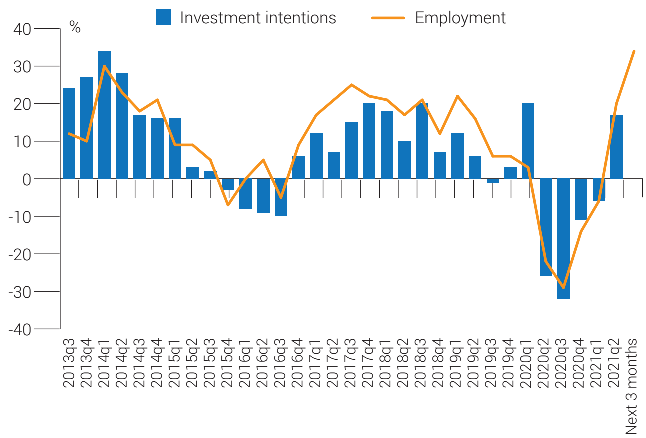
While in the first quarter of the year we were able to report positivity for the majority of the metrics tracked in *Manufacturing Outlook*, both employment and investment still remained in negative territory, but with high hopes for positivity in the second quarter. Now, in the second quarter, we can report that not only have both employment and investment produced positive balance figures, but they also surpassed the already generous forecasts assigned to them last quarter.

Despite employment having been in negative territory for the past four consecutive quarters, it has been trending upward since the final quarter of last year. This trend looks set to continue into the second half of the year, with manufacturer's reporting employment expectations for the third quarter of the year to be even higher, with an expected balance figure of 34%.

It must also be noted that this second quarter boom in employment intentions has occurred while the much-used Job Retention Scheme (JRS) is still in effect. It had been thought in the previous year that it would be unlikely to see significant growth in employment while the scheme was still active. Now that that growth has indeed occurred during the scheme's tenure, these employment figures demonstrate the renewed need manufacturers have for labour as their order books pick up at a pace faster than anticipated, as shown in our Orders section of the report.

Investment and employment jump into positivity, with even further positivity expected for employment

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑	20%	NEXT THREE MONTHS	↑	34%
INVESTMENT	NEXT TWELVE MONTHS	↑	17%			

In the previous edition of *Manufacturing Outlook*, the Chancellor had just announced a new business investment incentive scheme dubbed the 'Super Deduction', a scheme which gives relief at 130% of the qualifying cost of capital investments compared to the usual 18% writing down allowance for investment in capital assets. The scheme was launched straightaway after the budget, and so these incentives have certainly been able to influence the positive investment figures we're reporting in this edition. It's expected that this positivity will continue as the Super deduction scheme continues, but it also must not be ignored that business confidence within the manufacturing industry is also high, which will naturally drive up investment spending also.

Looking at how employment and investment intentions have varied between business sizes, we see that this quarter those smaller businesses in the £0-9m turnover category are not reporting as positive balance figures as those in the larger categories. This is particularly the case in investment, where those businesses in that smallest turnover band report a balance figure of only 3% for investment intentions compared to that of 39% in the £25m and over category. However, expectations for growth in employment in the coming quarter are significantly more balanced across all turnover groups.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	0%	0%	-10%
Metal Products	18%	23%	-5%
Mechanical	21%	40%	25%
Electronics	10%	30%	26%
Electrical	-8%	33%	10%
Rubber & Plastics	-25%	25%	-25%
TURNOVER			
£0-9m	10%	27%	3%
£10-24m	34%	37%	25%
£25m and over	28%	28%	39%

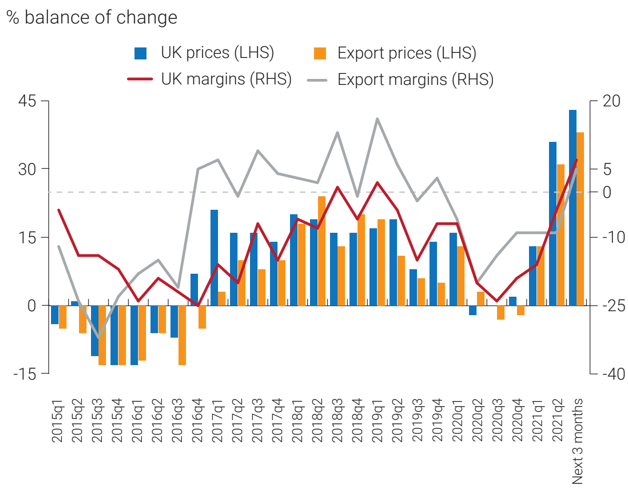
Source: Make UK Manufacturing Outlook Survey

PRICES & MARGINS

Average selling prices for Q2 indicate the same effects reported previously continue to impact UK manufacturers following the nation's exit from the EU. In other words, a sharp rise in costs due to trade disruptions, shipping delays, logistic costs and shortages of critical raw materials has led to the price of goods rising sharply across most subsectors. This raises concerns on the follow-up impact to be had on inflation which could result in higher costs for both businesses and household consumers. The latest data reports average UK prices have increased for a balance of 36% of manufacturers, whilst export prices have risen for a balance of 31% of manufacturers over the last three months.

A modest improvement in domestic margins has also been reported, albeit it remains negative on balance. In contrast, export margins remain unchanged at -9% for three quarters in a row. The continuation of negative balances for margins suggests even as prices are rising, profits are not. Last quarter this was explained by the likely incidence of higher costs being priced in only partially, and any costs that are not priced in are passed on to customers resulting in lower margins for most manufacturers. This will remain the case this quarter as cost pressures continue to rise due to the aforementioned reasons.

Selling prices rise for many manufacturers but margins remain negative



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑ 36%		NEXT THREE MONTHS	↑ 43%	
EXPORT PRICES	PAST THREE MONTHS	↑ 31%		NEXT THREE MONTHS	↑ 38%	
UK MARGINS	PAST THREE MONTHS	↑ -4%		NEXT THREE MONTHS	↑ 7%	
EXPORT MARGINS	PAST THREE MONTHS	↔ 9%		NEXT THREE MONTHS	↑ 5%	

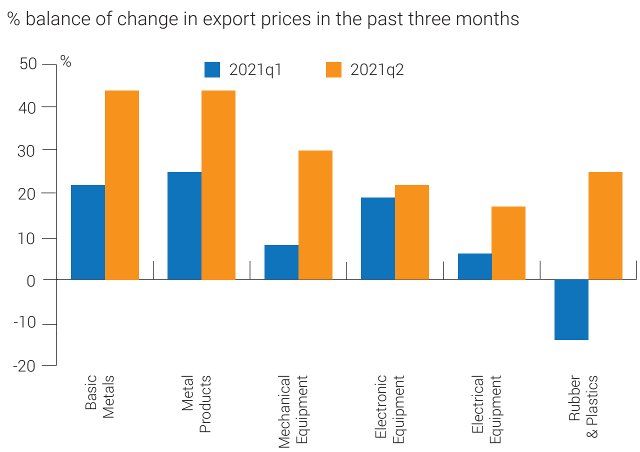
The impact on rising prices is observed subsector wise too. All intermediate industries have reported positive balances for Q2 for export prices suggesting inflationary pressures within manufacturing remains high. If these costs are not controlled, it can result in an overheating of the sector which can create more problems than solutions in the long run.

Over the next three months, manufacturers expect prices and margins to rise again.

The European Brent Price of oil averaged approximately $61 per barrel during Q1 2021, approximately a 24% increase from the previous quarter's average price. Average prices are now forecasted to hover around the $60 mark for 2021 and 2022 resulting in further cost pressures for an already squeezed manufacturing sector, particularly those industries that are oil intensive.

The Sterling-Euro exchange rate averaged around €1.15 in Q1 2021 (ONS), incrementally higher than its previous quarter average at €1.11. The positive news stories surrounding vaccinations, low infection rates and businesses reopening likely improved confidence in the Sterling from foreign investors.

Export prices of intermediate goods increasing

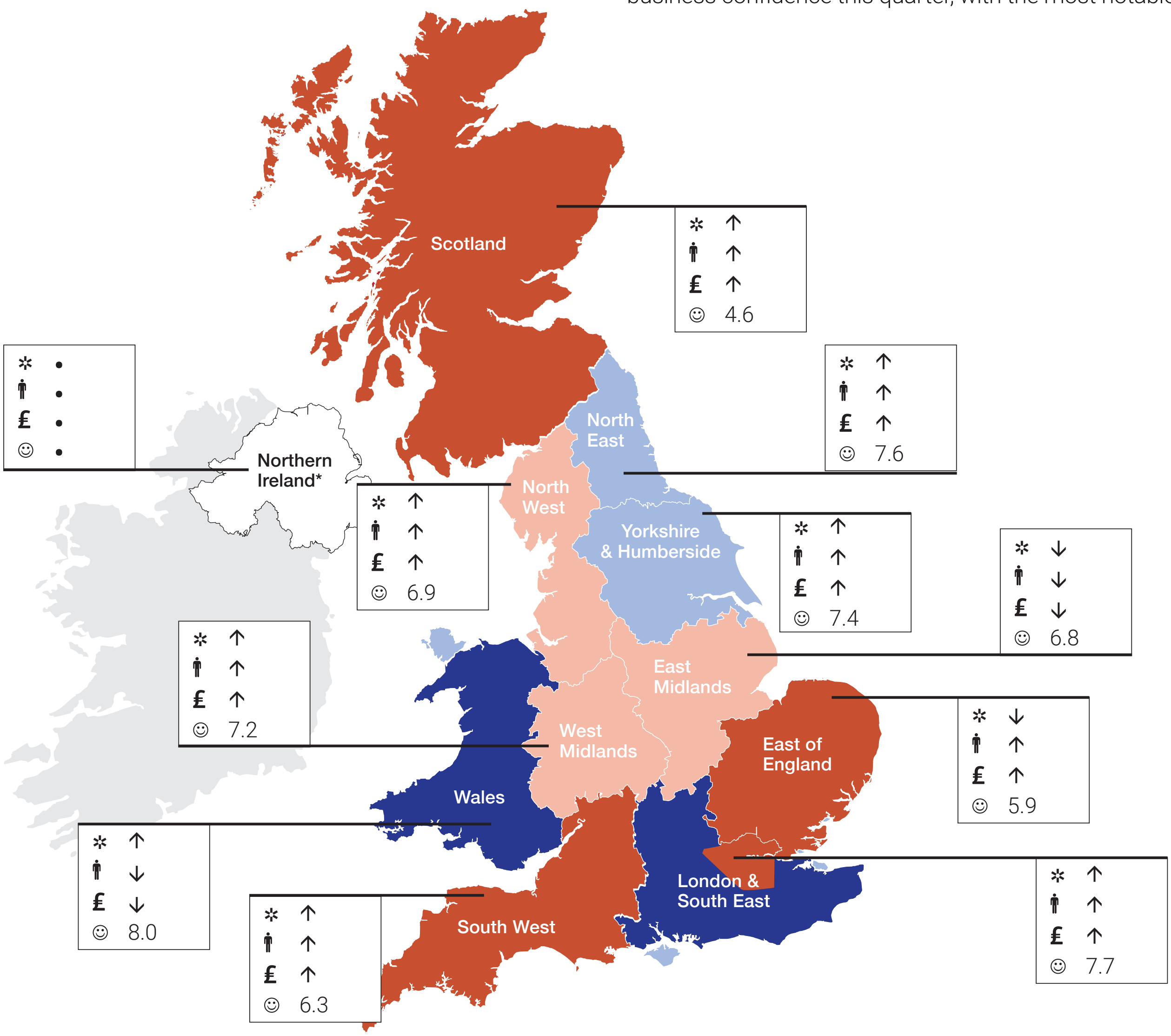


Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

Business confidence is regularly one of the most volatile metrics in our quarterly series as it is impacted by a wide range of variables that may include anything from significant socio-political events to daily business activity. Nevertheless, the metric correlates well with near-future business activity. The latest figures for confidence comes at a time where we appear to be at the end of the pandemic as vaccinations rise and lockdown restrictions ease. However, the risk of new COVID-19 variants as well as post-Brexit struggles still looms.

Six regions and nations reported improvements in their business confidence this quarter, with the most notable



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER

✲ OUTPUT

EMPLOYMENT

£ INVESTMENT

☺ BUSINESS CONFIDENCE

• INSUFFICIENT NI DATA FOR CALCULATION IN THIS INSTANCE

The map is coloured according to the business confidence levels difference from average UK business confidence

HIGH CONFIDENCE

LOW CONFIDENCE

Source: Make UK Manufacturing Outlook Survey

improvement reported by the South East & London. All regions and nations reported positive business confidence (above the '5' inflexion point), excluding Scotland. However, the confidence measurement in Scotland follows a different survey elicitation method, which means Scottish confidence values should be compared with other Scottish confidence values only. And so, Scottish confidence is the only location to maintain a negative stance on its outlook – which is unchanged on its Q1 level at 4.5 – and is likely a result of the recent political situation(s) in the nation impacting the perspective of businesses based there.

The South East & London reported the most "improved" confidence level from Q1, increasing by 2.2 points to 7.7. This was followed by the North East which improved by 1.7 points. The highest confidence in the UK was reported by Wales, however, this nation generally attracts a small sample size which should be minded when making comparisons. What can be assumed with confidence is the general upward trajectory of optimism is reliable.

Only the East Midlands reported a slight fall in confidence. It fell by only 0.3 points here and its current level is still well within positive territory at 6.8. The fall in confidence is reflective of the performance of the industry here which reported slightly worse, but still strong, results compared to Q1. The only metric still negative for the East Midlands is employment, at -7% balance for Q2.

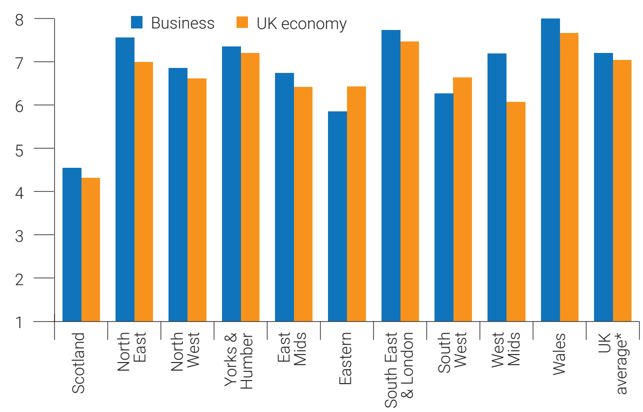
The headline UK average for business confidence is 7.2, the highest level since data collection for this metric began in Q3 2014. This new peak for confidence is to be expected given how close we are to a substantial reopening of the economy, and the media representation of vaccine effectiveness on new variants of the virus. However, the optimism is still somewhat surprising given the frictions in trading with the EU and rising cost pressures from raw material shortages, shipping delays and freight pricing – which suggests manufacturers expect these issues to be a temporary barrier.

UK ECONOMY CONFIDENCE

UK economy confidence, where we elicit the opinion of manufacturers' view on the whole national economy and not just their own business, has also improved by 1.1 points to just over 7. After turning positive last quarter for the first time since the pandemic began, the gap between business and economy confidence has narrowed substantially indicating many manufacturers are feeling strong about their own prospects as well as the prospects of those around them.

Both firm-level and UK economy confidence has increased for most regions

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



* Average =/= component parts due to instances of undeclared regionality

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	32	36	28	39	18	32
North East	57	57	57	43	14	57
North West	50	38	50	50	50	29
Yorks & Humber	50	50	64	29	-7	29
East Mids	25	58	33	42	8	17
Eastern	-29	14	-29	0	0	-14
South East & London	28	51	35	38	15	18
South West	27	36	36	9	18	45
West Mids	50	65	40	60	35	35
Wales	33	50	33	67	0	33
Northern Ireland*	–	–	–	–	–	–

* Insufficient NI data for calculation in this instance

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

The UK continues to hastily proceed with its COVID-19 vaccinations, with over 60% of the population having received at least one dose of the recommended two doses for most versions of the vaccine. The determination of the country to return to normal is beginning to bear some fruit as many industries reopen their doors to households and businesses alike. Nevertheless, concerns remain as the risk of new variants, whether those that are already in circulation or those that are yet to be, means that many may spend cautiously, preferring to save for a rainy day. In a similar manner, businesses will invest in new capital and R&D more cautiously too – until there is more certainty in the UK economy.

The UK is expected to ease restrictions significantly in the time to come, provided the success of the vaccinations are greater than the cost of rising infections, which will be expected to worsen as people return to the streets. It is unlikely to be a sharp rebound as the return to normal will be slower than the initial pandemic shock. Regardless of whether economic growth is fast or slow, many segments of the industry will be eagerly looking forward to doing business again, taking their staff off furlough and getting back to innovating.

The start of the year has been sluggish, with signs of positivity, for GDP growth which reportedly improved by 1.2% in March 2021 (ONS). However, due to a sharp fall in activity following the disastrous early days of Brexit, the UK economy overall declined in Q1 2021 by 1.5%. Without more recent data available as far as we know the UK economy is currently 8.7% below its pre-pandemic state in late 2019. Unfortunately, the stop-start style of economic activity makes historical comparisons complicated but within a crisis the most recent figures are aligned with easing restrictions and higher levels of confidence. At this stage, the only variables that can return us to declines depend on vaccine effectiveness and the likelihood of future lockdowns.

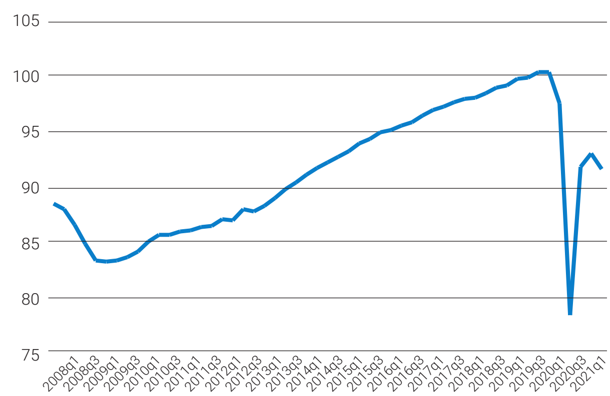
Despite what GDP figures say, the story of a return to normality will be different for each manufacturing subsector, and even more so, different for every business.

A sectoral inspection of the economy indicates Q1 growth had been dominated by the service sector, whilst manufacturing expanded by 2.1% in March 2021. This growth in manufacturing output was driven by an 8.3% rise in machinery and equipment output, according to the Index of Production (IoP). Alongside this subsector, textiles (6.8%), electronics (5.5%) and Rubber & Plastics (3.4%) also expanded between February and March 2021. However, electrical equipment (-1.9%) and transport equipment (-1.3%) both declined in the same time frame. The latest data highlights the different experiences felt by subsectors and industries such as transport equipment (which includes aviation).

As has been a recent feature of a number of Purchasing Managers Index (PMI) figures, a timelier reflection of business activity, suggests business optimism is high and new work has been returning speedily for many manufacturers – resulting in some of the highest PMI figures in decades. Yet the source of this high confidence is also shadowed by the worsening of supplier-lead times resulting in delays in shipments, shortages, increasing logistic costs and non-tariff barriers from the UK's exit from the European Union (EU).

GDP declines in Q1 2021

Quarterly Index (Q4 2019 = 100), Q1 2008 - Q1 2021



Source: ONS

Employment trends remain a cause for concern in manufacturing, as well as non-manufacturing sectors. For over a year now the Government's Job Retention Scheme (JRS) has played a significant role in protecting jobs and keeping the industry in limbo until it can be reopened. Unfortunately, a series of last-minute extensions to the scheme did likely result in more redundancies than there otherwise would have been if businesses were able to plan. However, the scheme has still been invaluable to those struggling the most and recent Make UK data indicated furlough take-up did increase slightly at the start of this year as businesses faced the uncertainty of a new trading environment. Our most recent manufacturing monitor survey reported that 44% of manufacturers had no staff furloughed, whilst a further 38% of firms only had less than 10% of their workforce on the scheme. Many of these manufacturers utilised flexible-furlough bringing staff on and off the scheme – which is particularly useful for an industry that operates under similar cyclical conditions.

Nevertheless, further job losses are expected once the JRS expires for good. Though several forecasts by various analysts suggest we are less pessimistic about unemployment today compared to late 2020. The Office of Budget Responsibility (OBR) forecasts the UK unemployment rate to peak at 6.5% by the end of 2021, which is a more favourable expectation than previous forecasts. Sector-wise, the manufacturing sector's unemployment rate improved slightly from 4.7% to 4.1% between Q4 2020 and Q1 2021 indicating hiring levels were returning – which is explainable given the sector was not subject to stringent lockdown restrictions. Despite the slight improvement in employment levels, it should be noted that activity in manufacturing is highly dependent on demand from downstream sectors. This also includes Accommodation and Food services, which currently has an unemployment rate of 9.5%. This can indirectly affect manufacturing subsectors through supply-chains – such as Food & Drink, Automotive, Aerospace and Paper & Printing.

As was mentioned last quarter, a plan that prioritises job creation should precede saving jobs in the future. The UK has a unique opportunity to reset its priorities towards green and innovative sectors but it will fail to achieve its targets without supporting those industries that have the greatest capabilities to be green and innovative. That sector is manufacturing. This includes developing an ecosystem for scale-ups, which has a different meaning for manufacturers when compared to their highly scalable counterparts in software and financial technologies. Manufacturers cannot necessarily scale the size of their business by growing their workforce exponentially, instead, the Government need to think more creatively on the appropriate ecosystem for manufactures to scale their value-chains, production lines, research capacity and access new markets.

As is regularly mentioned in our quarterly review, no economy can ignore the importance of climate change when planning. The Government's 10-point plan presents a strong starting point for industry, including announcements to open a UK Infrastructure Bank to fund a large scale project that tackles climate change as well as support the levelling up initiative. However, we must be careful not to assume industry is already ahead of the game. Energy usage declined significantly during the pandemic which resulted in carbon emissions falling enabling many to conclude the nation is now much "greener" than it was pre-pandemic. As the economy reopens, factories restart, and people return to normal life carbon emissions will increase. As will waste. It is imperative Government get the incentives to achieve Net Zero right and this may require taking much of the transition into their own hands.

The pandemic is an issue faced by all manufacturers across the globe. However, the UK also finds itself in a unique situation that requires it to navigate a new trading relationship with its most important economic partner, the EU. The first few months since the transition period ended has brought with it a plethora of challenges, both expected and unforeseen. Exports declined by approximately 40% in January alone as businesses opted to delay orders in order to assess the new trading environment from distance. Recent figures indicate exports have been rising again, increasing by 8.6% in March which was dominated by the performances of automotive and textiles.

Despite the situation improving slowly, there are several limiting factors that must be watched and dealt with promptly. For example, the current issues between borders are having a disproportionate impact on SME's and micro-businesses who are unable to utilise groupage systems to fill HGVs and deliver goods overseas. Unfortunately, many small firms do not produce enough product to justify hiring out their own Lorries and HGVs to export goods themselves. Even those that could are restricted by a shortage of drivers for such vehicles as many do not wish to deal with the abundance of red tape associated with crossing between the UK-EU borders. On top of these, supply-chain disruptions in the form of shortages of raw materials, rising input prices and a lack of custom advisors for inexperienced businesses result in a perfect storm for smaller businesses.

Naturally, the UK's economic performance is not solely related to its own internal activities as the recovery of other countries is important to its success. As stated at the beginning the UK has been very successful with its vaccination programme so far but the pandemic's threat will never subside if it exists outside of our borders. It is important that not only do we lead by example on how to vaccinate an entire nation but do our utmost to support those countries that are struggling. According to the Organisation for Economic Cooperation and Development (OECD), GDP projections for Q4 2021 versus the pre-pandemic level of GDP is expected to be 4.8% lower for the UK – the seventh-worst expectation in the OECD. In comparison, India is expected to be 7.8% worse off by the end of this year, whilst major economies like that of the US could even expect to grow slightly (0.2%).

UK Economic Forecasts

% change except where stated

	2020	2021	2022
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.16	1.16
Exchange rate ($/£)	1.28	1.38	1.4
Exports	-13.2	2.0	8.5
Imports	-17.8	6.9	6.9
Current account (% GDP)	-3.4	-4.1	-3.4
OUTPUT			
Manufacturing	-9.9	7.8	3.4
GDP	-9.9	7.5	5.5
COSTS AND PRICES			
Average earnings	1.6	3.2	0.8
Oil price (Brent Oil $/bl)	41.8	62.1	60.2
EMPLOYMENT			
Manufacturing (000s)	2,618	2,546	2,577
Rest of economy (000s)	35,029	34,416	35,400
Unemployment rate (%)	4.5	5.3	5.1

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

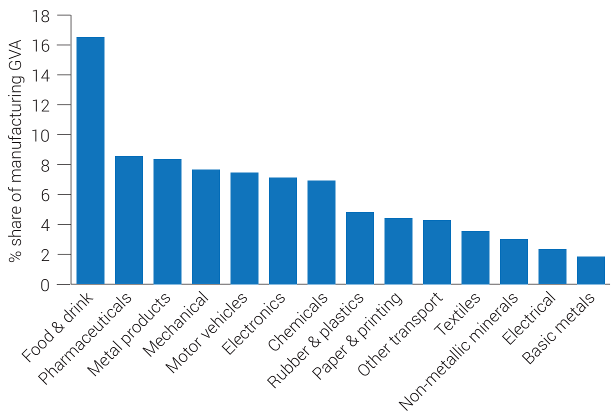
	GDP			INFLATION		
	2020	2021	2022	2020	2021	2022
US	-3.5	7.7	4.5	1.3	3.0	2.4
Eurozone	-6.8	4.2	4.8	0.3	1.7	1.4
France	-8.3	5.4	4.7	0.5	1.2	1.3
Germany	-5.3	3.5	4.4	0.5	2.3	1.5
Japan	-5.0	3.0	2.4	0.0	-0.2	0.2
China	2.3	8.9	5.5	2.5	1.5	2.3
India	-7.1	10.2	6.4	6.6	4.6	4.8
World (2015 PPPs)	-3.6	6.3	4.7	2.8	3.5	3.0

Source: Oxford Economics

SECTOR FORECASTS

Q2 2021 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: ONS

FOOD & DRINK

The **Food & Drink** subsector, the largest manufacturing subsector in the UK, saw its total share of UK manufacturing gross value-add reduce by just under half a percent. This is a marginal change compared to midway through last year that saw the subsector's share grow amongst the sharp rise in demand for its products domestically as the global pandemic stressed global food & drink supply chains, forcing many countries, including the UK, to become significantly more dependent on their domestic production quite suddenly. Output forecasts for the subsector have been upgraded, just as have overall manufacturing forecasts been upgraded, albeit not to the same degree, with a 3.1% growth in output forecast for the subsector in 2021. Employment within the food & drink manufacturing industry is currently forecasted to decline slightly overall in 2021, likely a symptom of the demand for domestic production cooling off as international trade flows ease as the pandemic's stranglehold on international logistics begins to loosen.

ELECTRONICS

The **Electronics** subsector, the sixth-largest manufacturing subsector in terms of GVA, has seen its share of the total manufacturing industry remain roughly unchanged. However, what has seen significant change is the 2021 output forecast for the subsector. Standing at 10.5%, this is above the manufacturing overall forecast of 7.8% for the year, which is already high. Despite the infamous supply challenges the electronics subsector has endured over the past year, stemming from the global shortage of semiconductor components, demand has been high, particularly in the consumer electronics segment. Employment in the subsector is expected to buck the trend in 2021, with a positive increase of 1.4% forecast for 2021, above the slightly negative expectation for manufacturing employment overall.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector has suffered consistent negativity in output forecasts throughout the pandemic, largely stemming from depressed demand from key downstream sectors in industries such as Automotive and Aerospace. As the figures suggest the general 'tide' for UK manufacturing is rising, so too has this filtered into forecasts for the Basic Metals subsector. Growth in output for the subsector is forecast at 1.5%, although this is still quite below the UK manufacturing average of 7.8%. Conditional on the performance of key downstream sectors throughout the year, the output forecast has space to improve in the upcoming quarter. The current 2021 employment forecast for the sector stands close to the UK average at -2.3%.

While the **Fabricated Metals** subsector suffers similar challenges to that of Basic Metals, the outlook is more positive for 2021 output. Both subsectors suffered similar declines in output of approximately 10% in 2020, but the current forecast for the Fabricated Metals subsector for 2021 stands at 8.3%, in line with the overall UK manufacturing average. Likewise, this trend-defeating positivity is seen in the employment forecast too. While a 1.1% employment growth forecast is nothing significant in absolute terms, it stands in contrast to the negative overall contraction expected in UK manufacturing employment in 2021. The large growth in output expected in the Automotive sector in 2021 will be a key factor as to why the Fabricated Metals outlook has improved.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector is forecast to have a sizeable bounce-back in output in 2021. Having been 3rd biggest losing subsector in terms of output decline in 2020, this forecasted improvement in output for 2021 by 13.9% does not make up the loss in value the industry endured, although it is above the UK average. The subsector is positioned well for continued output growth into next year as well. The Mechanical Equipment subsector is typically a beneficiary of increased investment expenditure by other business in the sector, and as the data suggests investment expenditure will be increasing throughout 2021, this will translate into further demand for this industry. Despite the positive outlook for output, employment in the subsector is forecast to decrease this year by -6.4%.

TEXTILES

The **Textiles** subsector is one of the few industries that both endured double-digit declines in output for 2020, but is also now forecast for a double-digit recovery in output for 2021. With a forecasted rise in output by 18.6% in 2021, it is the subsector with the second-largest growth forecast for 2021. Its forecast for growth is also just over twice that of the UK manufacturing average. Better-than-expected demand for the subsector's products has fuelled these expectations, particularly in the consumer retail sector. With this strong demand performance expected to continue into the second half of the year, the textiles sector will likely continue to benefit. Employment in the subsector is also expected to grow in 2021, by 3.8%. Again, this bucks the negative overall trend expected for UK manufacturing employment.

PAPER & PRINTING

As has been the case for the majority of subsectors this quarter, the **Paper & Printing** subsector's output forecast for 2021 has been revised upward. At 5%, this is much higher than the 0.9% that was forecast last quarter but still remains below the UK manufacturing average of 7.8%. It had been theorised that a greater cushion would have been afforded to the subsector throughout 2020 due to the rise in demand for packaging amongst the pandemic, although stiff international competition saw little buffer afforded. After a significant decline of 10% in employment in 2020, employment forecasts for 2021 stand stagnant, and only at 0.2%, although this is above the negative UK manufacturing average.

ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector is forecast to make up a large degree of the output it lost in 2020, with a growth of 10.3% expected. This forecast outperforms the UK average, which in the last edition of *Manufacturing Outlook* it did not. The government's levelling up ambitions, particularly in terms of digital infrastructure, bode well for the sector over the next few years, conditional on the speed at which these plans are realised, if at all. However, the employment outlook is more pedestrian, with a growth of 2.1% expected for 2021. Contrast this with the loss of employment in the subsector of -11.2% in 2020, therefore total employment in this industry will have declined over 2 years.

NON-METALLIC MINERALS

The **Non-metallic Minerals** subsector continues to see its output forecasts revised. The main driver behind these positive revisions is the speed at which construction activity is resuming in the UK, which has continued to fare better than expected. As the Non-metallic Minerals' key customer is the construction industry, it's natural that its performance is tightly linked to the amount of construction activity being undertaken. The output forecast for the subsector has been revised up to 15.6% for 2021, which is just under twice as high as it was forecast in the previous quarter. Employment is also expected to pick up, with an increase of 4.2%.

PHARMACEUTICALS

The **Pharmaceuticals** subsector output performance has been the stand out subsector throughout the pandemic. Rather unsurprisingly, it was the only subsector to enjoy not only positive, but double-digit growth in output in 2020. Expectations for growth have now cooled off somewhat for the subsector, although it is still expected to grow by 3.7% in 2021. Overall in real terms, over the past 3 years, the pharmaceuticals sector has experienced absolute growth, likely the only subsector able to maintain such an achievement amongst a global pandemic, and a national economic downturn. Not dissimilarly to output, employment in the subsector grew significantly in 2020, but expectations remain positive for 2021 but have cooled off, with a growth of 2.6% in employment expected for 2021.

CHEMICALS

The **Chemicals** subsector has had a fairly consistent experience throughout the pandemic. The subsector saw demand for its sanitation products peak throughout the last year, which offset the general loss seen from other demand streams during the wider industry's suppression. Output performance for the year in 2020 was 2.7% growth, and now for 2021 further growth is forecasted at 3.7%. While employment in 2020 stayed largely stationary, bucking the wider manufacturing industry trend, employment in 2021 is forecast to decline by -5.4%, almost twice as severe of a decline as the UK industry average.

RUBBER & PLASTICS

The **Plastics** industry is currently undergoing a supply shortage issue, with many UK manufacturing business unable to source the proper plastics inputs in suitable time frames. Where they do manage to source the right plastics, the price is often significantly inflated. As wider UK manufacturing production continues to pick up throughout the year, these supply issues within the plastics industry, and subsequent price pressures, are expected to continue.

A key downstream industry for the Rubber subsector in the UK is the automotive sector, as the overwhelming majority of UK rubber manufacture is linked to tyre production. The expected pick up in output for the Automotive sector this year will filter into increased demand and subsequent output for the Rubber subsector. Overall the **Rubber & Plastics** subsector is forecast to have an above UK average growth in output in 2021 at 12.5%, but a decline in employment in line with the UK average at -3.3%.

MOTOR VEHICLES (AUTOMOTIVE)

The **Motor Vehicles** subsector holds two accolades in recent *Manufacturing Outlook* sector forecasting. In the first instance, it was the subsector that we reported to have the most significant decline in output for 2020, with a loss of -25.6%. Now, for 2021, a significant bounce-back is forecast, with output levels expected to grow by 23.6%. While this yo-yo effect may suggest extreme volatility within the industry at first glance, most of the variation is explained by the widespread production shutdowns in UK car plants in 2020. These shutdowns were driven by a multitude of factors, but a chief contributor to their temporary shuttering was automotive manufacturers' inability to source critical parts from the international suppliers during the height of the pandemic, often with no alternative available on the global market. While output is forecast to grow substantially, employment is expected to continue to decline, at -4.9%.

OTHER TRANSPORT

The **Other Transport** sector is the only subsector in this quarter of forecasting in which a declining output is expected for 2021. Not only that, but the forecast for the subsector has in fact been revised downward following on from last quarter's forecasting. The current forecast for the subsector's output in 2021 is -7.8%. Which, for comparison, is the polar opposite of the UK manufacturing average output expected growth rate for 2021 of 7.8%. The subsector is comprised of the core industries Defence, Aerospace and Shipping. It's these industries, particularly in the case of Aerospace, that continue to suffer significantly as a result of restrictions, and loss of demand, for international travel. Employment in the Other Transport industry is also expected to continue to decline, by -9.8% This is the greatest forecast rate of decline for employment out of all of *Manufacturing Outlook's* covered subsector's this quarter.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2020	2021	2022	2020	2021	2022
Basic metals	-9.5	1.5	1.1	-4.9	-2.3	-4.0
Metal products	-9.5	8.3	3.9	-13.8	1.1	2.4
Mechanical	-20.1	13.9	8.6	-5.1	-6.4	5.7
Electronics	-7.3	10.5	2.9	2.7	1.4	-0.6
Electrical	-11.8	10.3	0.0	-11.2	2.1	-0.4
Motor vehicles	-25.6	23.6	4.8	-10.8	-4.9	7.8
Other transport	-22.2	-7.8	8.1	-2.8	-9.8	-1.9
Food & drink	-5.7	3.1	5.2	-1.0	-1.8	1.3
Chemicals	2.7	3.7	-1.6	0.1	-5.4	-5.3
Pharmaceuticals	13.6	3.7	2.1	14.0	2.6	-3.2
Rubber and plastics	-8.2	12.5	3.2	6.7	-3.3	3.9
Non-metallic minerals	-10.4	15.6	2.5	2.5	4.2	3.6
Paper and printing	-11.5	5.0	1.5	-10.6	0.2	1.7
Textiles	-14.6	18.6	0.3	9.1	3.8	-1.0
Manufacturing	-9.9	7.8	3.4	-2.8	-2.6	1.3

Source: Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

ENHANCING CASH FLOW WITH THE NEW SUPER-DEDUCTION CAPITAL ALLOWANCE

Following the record-breaking lows seen across the manufacturing sector this time last year, it is promising to see manufacturers continuing to demonstrate resilience with improvements in output, orders and investment this quarter.

COVID-19 has created significant disruption for manufacturers and it has never been more important to focus on cash flow. One area that manufacturers should be considering is making sure they claim all relevant tax allowances and reliefs available to reduce the outflow of cash in tax payments or raising cash through tax repayments.

Conducting a detailed review of capital allowances can help reduce current tax liabilities and considering prior years expenditure, where capital allowances may not have been claimed or fully reviewed to maximise the allowances available, could boost cash flow by generating tax repayments.

THE NEW SUPER-DEDUCTION CAPITAL ALLOWANCE

Over the years the government has used different types of capital allowances to boost business investment and, in the UK Budget on 3 March 2021, to help with the economic recovery from the COVID-19 pandemic, the Chancellor announced two new enhanced capital allowances – the 'super-deduction' and the 'SR allowance'.

WHAT ARE THE NEW ALLOWANCES?

The allowances are temporary first year allowances (FYA) and comprise:

- 'Super-deduction' - a 130% FYA for capital expenditure incurred on plant and machinery that ordinarily qualifies for the 18% main pool rate of writing down allowances
- 'SR allowance' – a 50% FYA for capital expenditure on plant and machinery that ordinarily qualifies for the 6% special rate pool, (i.e. including integral features in a building and long life assets).

Both the new allowances give companies investing in new and unused qualifying equipment a much higher tax deduction in the tax year of purchase than would otherwise normally occur. The temporary FYAs apply for capital investments made between 1 April 2021 and 31 March 2023.

The FYAs are only available to companies subject to corporation tax and only where the contract for the plant and machinery (including fixtures within a building or structure installed under a construction contract) was entered into after 3 March 2021 and expenditure is incurred after 1 April 2021.

The FYA are available in addition to the ongoing Annual Investment Allowance (AIA), which already gives 100% relief for costs of qualifying plant and machinery in the tax year of purchase. The AIA has been set at £1m to 31 December 2021.

WHAT INVESTMENTS QUALIFY?

Although not all business investments will qualify for the new allowances, capital expenditure on new main pool and special rate pool plant and machinery should be eligible.

However, it is important to remember that there are certain assets that will not qualify for the FYA main pool (for example, cars have their own capital allowance rates) and that second hand assets will just go into the pools as normal.

In addition, the FYAs do not apply to expenditure on plant and machinery acquired for the purposes of leasing or general hire. Similarly, expensive machinery acquired by hire businesses will not qualify. There are also certain specific rules to consider, for example, hire purchase agreements, the future disposal implications of any assets that have qualified for the FYAs and avoiding any contracts that could be considered contrived or on uncommercial terms that could be excluded.

Read more about the super-deduction here:
www.bdo.co.uk/en-gb/insights/tax/capital-allowances/capital-allowances-super-deduction-how-it-works

Steve Watts
Tax Partner
07970 114787
steve.watts@bdo.co.uk

IDEAS | PEOPLE | TRUST

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 that 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
Senior Economist
fkhan@Makeuk.org

James Brougham
Senior Economist
jbrougham@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.

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

Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,600 offices in 167 countries. We operate from 18 offices across the UK, employing 5,650 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:

Richard Austin
Head of Manufacturing, BDO LLP
07808 24613
richard.austin@bdo.co.uk

Baljit Bhamra
Marketing and Business Development Manager, BDO LLP
0121 352 6296
baljit.bhamra@bdo.co.uk

Front cover image © University of Southampton. Mechanical Engineering.

The Manufacturers' Organisation

makeuk.org

Ref: 21.04.POL.JB.FK.NB