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The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2020 QUARTER 2

With support from:

Scottish Engineering and Manufacturing NI

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FOREWORD

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In the summer of 1854, a mysterious disease swept through London, killing hundreds of people in a matter of weeks. A Yorkshire physician by the name of John Snow had recently set up a medical practice at 54 Frith Street. Snow witnessed many of his patients succumb to the 'Asiatic cholera' outbreak and was determined to ascertain the cause of the disease.

He began by making a dot map, meticulously recording the address of every case and interviewing the victims' families to understand their daily habits in a process we would now call contact tracing. In doing so Snow noticed that nearly all of those infected had used the same water pump on Broad Street, around the corner from his office in Soho. Realising there must be something in the water he had the handle of the pump removed to render it unusable after which there was an immediate drop in the number of cases.

In an era before the discovery of bacteria, John Snow did not yet have a cure for the disease but the methods he used to track and trace the source and spread of the contagion were the origins of modern epidemiology. His discovery would revolutionise medical science leading to new standards of interpersonal and workspace hygiene including, for the first time, the widespread practice of hand-washing, the use of personal protective equipment (PPE), and the social isolation or quarantining of affected persons and materials to prevent the spread of infection.

In the midst of another epidemic, manufacturers and the public at large are again having to adapt to new methods of virus tracing and interpersonal and workspace hygiene. As this quarter's *Manufacturing Outlook* makes clear, the impact on our industry and economy from COVID-19 has so far been enormous.

Output is down to an all-time record low. Both domestic and export demand have declined to levels comparable to the worst of the Global Financial Crisis, but have done so in half the time. All subsectors within UK manufacturing have seen their order books shrink. Prices and margins have tightened significantly and cashflow is being squeezed. Confidence has collapsed and firms are holding back on investment. Even with the Government's furlough scheme redundancies are increasing. There is little respite in sight. Most firms expect further falls before a slow and weak recovery begins.

However, pandemic disasters are never just destructive. They also create change, and often spark scientific discoveries, industrial innovations, market opportunities, and social reforms. The 1854 cholera outbreak was followed by investments to improve public health to stop populations getting the disease in the first place; research and development of new medicines and vaccines to treat and cure the disease and related illnesses; and international cooperation to prevent another catastrophic economic downturn accompanying a future outbreak. While the understanding of epidemic disease has improved considerably since the time of John Snow, those same steps will be required to recover from this epidemic and ensure industry and our economy can make it back to normal again.

HEADLINES

Make UK's Q2 2020 *Manufacturing Outlook* report, in partnership with BDO, is the second edition since the UK left the EU as well as the first to include a comprehensive overview of the impact, so far, of COVID-19. Our previous publication, which reported emerging downturns across manufacturing even before the COVID-19 crisis had begun, indicated that many UK manufacturers were, at the time, feeling positive about the future, and a great number even gearing up to commit to capital investments in long-term projects.

Unfortunately, these new results make clear that those expectations have swiftly been undone by this unprecedented pandemic.

Throughout 2019 the economic cycle was pockmarked with episodes of last minute safety stockpiling in anticipation of each EU exit deadline, as well as hasty attempts to clear out warehouses when each no deal deadline was averted. Nevertheless, manufacturers indicated they were looking forward to a period of cyclical normality following the implementation of the transition period which they expected would provide some room to prepare for a new trading environment. Now, however, thanks to these latest unforeseen events, confidence in the business and economic environment is down sharply again.

As a result of the current crisis, the latest survey shows the most negative output balance since Make UK's records began almost 30 years ago at -56%.

UK orders have been negative since Q3 2019, whilst all indications that the domestic market was slowly improving have been wiped away with the latest result of -52% on balance. Similarly, export orders mirrored this decline, also at -52%, highlighting the devastating impact the pandemic has had on our international trade partners too.

The employment balance came in at -22% this quarter indicating that manufacturers have opted to lay off workers despite having access to the government's very supportive job retention scheme. However, the impact of this scheme appears to have nevertheless mitigated an even larger increase in the unemployment rate based on Make UK survey results showing a quarter of companies plan to make redundancies within the next 6 months, and a quarter of those could cut up to half their staff, while only a third of all manufacturing firms have definitively ruled redundancies out. The concern now is whether the furlough scheme can be wound down in a way that averts rather than postpones mass job losses.

Following strong indications that manufacturers were ready to invest in capital in our Q1 report, the recent crisis has evidently flipped investment intentions on its head.

Both UK and export prices have fallen this quarter, albeit the latter remained marginally positive. Margins, however, collapsed further into negative territory as manufacturers saw orders almost disappear causing cuts to cash-flow and profits.

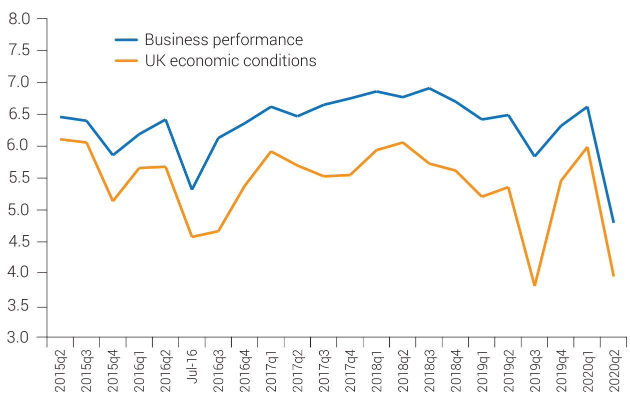
INDICATOR	BALANCE	CHANGE	
Confidence	4.79	↓	Business confidence falls following promising Q1 result
Output	-56%	↓	Output balance falls to survey record low
UK orders	-52%	↓	Domestic orders equals financial crisis low
Export orders	-52%	↓	Export orders falls sharply as well
Employment	-22%	↓	Firms cut jobs despite the furlough scheme
Investment	-26%	↓	Investment intentions decline sharply following a strong Q1

Source: Make UK Manufacturing Outlook Survey

Confidence, perhaps inevitably, has dipped significantly across the country.

Confidence down following a positive start to the year

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

Even before COVID-19 brought UK manufacturing activity to an almost complete standstill Make UK's *Manufacturing Outlook* survey, in association with BDO, was showing steep declines. Q1 2020 saw an output balance of just 2%. At the time this was due to UK manufacturers winding down their additional stock purchases following the October 31st EU exit deadline combined with a fall in customer orders, most alarmingly from overseas. During this period COVID-19 was emerging across East Asia and its impact on UK manufacturing was only beginning to be felt, mostly through disruptions and delays in manufacturers' supply-chains.

This quarter's survey covers the period of the early days of COVID-19 entering and spreading across the UK, through to the full government mandated lockdown coming into effect. While 95% of UK manufacturers have remained operational, at least in part, throughout this period, our results show the full impact of the lockdown on plants, supply-chain and markets.

As such, this *Manufacturing Outlook* edition for Q2 2020 shows an output balance of -56%, the worst ever on record.

PAST THREE MONTHS	↓	-56%	NEXT THREE MONTHS	↑	-42%

Manufacturers' expectations for recovery are alarming. Make UK members predict their output balance to be -42% over the next three months. This is the worst score they have ever predicted in this quarterly survey.

This worrying output balance is reflected in the results across almost all individual subsectors as well.

Basic Metals reported an improved, though still negative balance of -5% following last quarter's -20%. This is partly due to the reassurance brought by the much anticipated commitment by Chinese firm Jingye to invest £1.2 billion in British Steel generating newfound confidence in a domestic industry that has really struggled in recent years. Nevertheless, overall the sector continues to struggle with demand falling in key downstream companies.

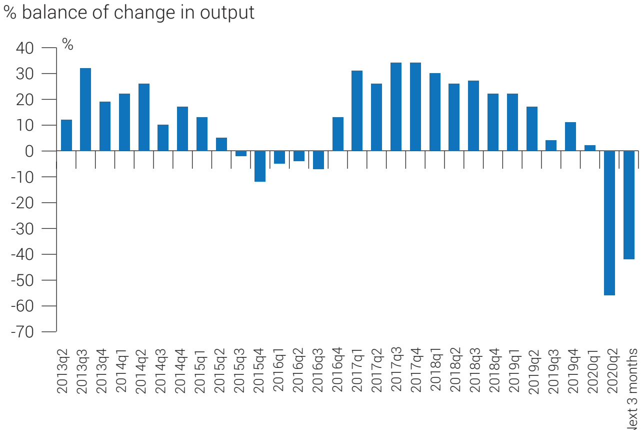
Metal Products output balance has fallen sharply to -48%, this was to be expected as the subsector relies heavily on orders from other subsectors, such as Motor Vehicles, Aerospace and Construction – all of which have been among the worst hit by the pandemic.

For similar reasons, mechanical subsectors such as Machinery Equipment, Electrical Equipment, and Electronics all also reported very negative output balances, at -70%, -67%, and -54%, respectively. At a time when the need to automate is increasing, it is concerning that these key subsectors, which serve as a proxy for investment in new technologies across the wider economy, are reporting such poor results. On average, all three sectors expect these declines to continue over the next three months.

Rubber and Plastics reported a worsening output balance of -45% this quarter. Although negative, this sector has observed mixed outcomes in recent surveys. Rubber firms have, as expected, reported falls in income due to a number of key intermediate sectors suffering declines whilst plastic goods have seen an increase in output for various reasons, including demand for PPE products and supermarket food packaging both having increased during the pandemic.

Output lowest on record

% 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	-5%	-28%
Metal Products	-48%	-39%
Mechanical	-70%	-52%
Electronics	-54%	-8%
Electrical	-67%	-60%
Rubber & Plastics	-45%	-64%
TURNOVER		
£0-9m	-57%	-52%
£10-24m	-30%	-27%
£25m and over	-35%	-32%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The total order balance decreased sharply to its lowest level ever of -53% this quarter.

The previous *Manufacturing Outlook* publication reported a negative balance for domestic orders for the third consecutive quarter. However, before the current COVID-19 crisis domestic orders were at least trending in an upwards direction. Now, the unexpected shock of the COVID-19 crisis has all but undone that beacon of optimism.

The loss of income will no doubt impede the sector's ability to recover and will particularly hit businesses that rely solely on the domestic market for their income. Ominously, expectations for the next three months are that UK orders will continue to disappoint.

As reported in the data for output, the latest survey reported a similar set of results for UK orders across the industry.

UK ORDERS	PAST THREE MONTHS	↓	-52%	NEXT THREE MONTHS	↑	-41%
EXPORT ORDERS	PAST THREE MONTHS	↓	-52%	NEXT THREE MONTHS	↑	-45%
TOTAL ORDERS	PAST THREE MONTHS	↓	-53%	NEXT THREE MONTHS	↑	-41%

Expectations for the next three months are also very distressing at -41% on balance for total orders.

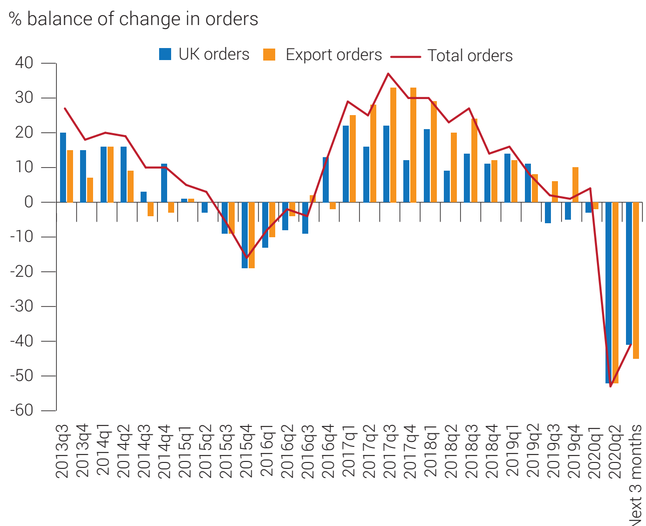
Last quarter's edition showed that export orders had turned negative for the first time since the aftermath of the shock Brexit referendum result in Q3 2016. The downturn last quarter thus showed that export demand for UK made goods was in decline even before the coronavirus epidemic hit our shores. Exports play a crucially important role for UK manufacturing as many firms sit in the middle of supply-chains creating value in goods globally. The current crisis has exposed vulnerabilities in those supply-chains and has demonstrated the type of costs that could be incurred should the UK fail to negotiate a trade deal with the EU by the end of the transition period.

UK ORDERS

UK orders fell to -52% this quarter, ending a series of marginal improvements in the domestic market seen over the last three quarters. As a result of demand falling across almost all major industries, many UK manufacturers have not only seen cancellations of existing orders but a reduction in future orders too.

Basic Metals reported a balance of -11% with expectations for a worse -22% in the next three months. Weak demand in a number of downstream subsectors,

Manufacturers witness orders disappear



Source: Make UK Manufacturing Outlook Survey

such as Motor Vehicles, Aerospace, and Construction, has pushed domestic orders in Metal Products to -46%.

As expected subsectors that prominently produce intermediate goods have seen orders fall sharply. Mechanical Equipment, Electrical Equipment and Electronics each reported balances of -66%, -52%, and -39%, respectively. Their expectations for the future are also concerning and the consequent investment gap bodes negatively for UK manufacturing in the long-run.

Rubber & Plastics reported a relatively better -18%, particularly as a result of its strategic importance in providing PPE equipment for workers across the nation. Yet, on balance, the sector's domestic order books have still declined.

EXPORT ORDERS

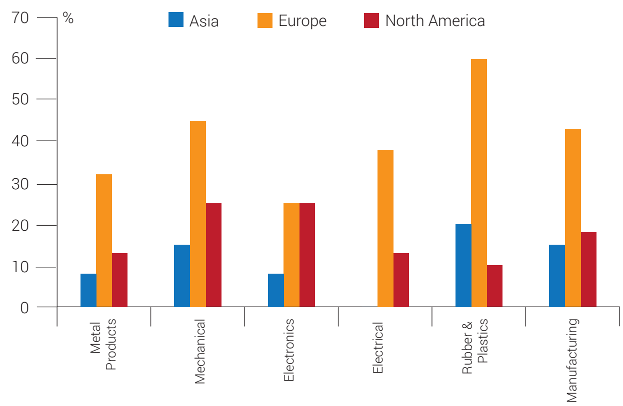
Unsurprisingly, the ongoing epidemic has exposed a plethora of vulnerabilities in manufacturing supply-chains as well as logistical barriers associated with accessing air and shipping freight. The crisis has demonstrated how tariff barriers are not the only impediment to frictionless trade. Indeed, many Make UK members are already making plans to review supply-chain resilience in light of the non-tariff barriers the pandemic has created.

Export orders were historically a significant and generally stable source of income for manufacturers. However, export demand has fluctuated since 2016 and the latest disruption, this time caused by COVID-19, has resulted in export orders coming in at -52% this quarter. As with the fall in domestic orders, this exceptionally negative score was felt across the range of manufacturing subsectors.

The EU remained the most important foreign market for the UK this quarter, and Make UK members say it will likely remain so regardless of how trade negotiations progress. The top three is then completed by North America followed by Asia.

EU remains top market amid crisis

% 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	-11%	-22%	-29%	-25%	-21%	-22%
Metal Products	-46%	-40%	-46%	-49%	-46%	-46%
Mechanical	-66%	-50%	-60%	-44%	-64%	-49%
Electronics	-39%	-26%	-33%	-33%	-42%	-25%
Electrical	-52%	-45%	-68%	-61%	-62%	-38%
Rubber & Plastics	-18%	-36%	9%	-18%	-18%	-36%
TURNOVER						
£0-9m	-53%	-49%	-51%	-49%	-54%	-50%
£10-24m	-29%	-36%	-35%	-29%	-29%	-30%
£25m and over	-39%	-21%	-31%	-33%	-29%	-24%

Source: Make UK Manufacturing Outlook Survey

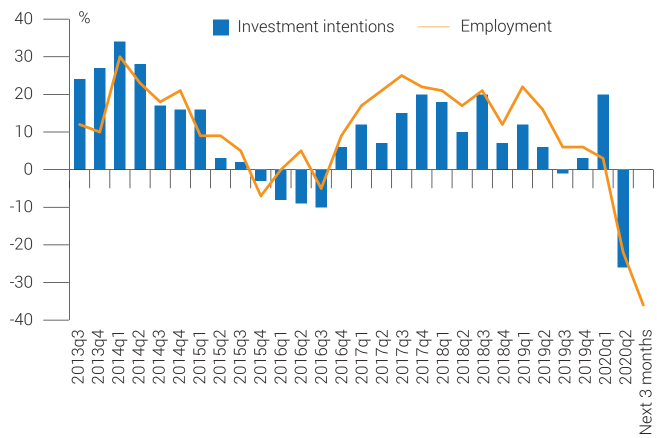
EMPLOYMENT & INVESTMENT

Although the Government's furlough scheme has allowed many manufacturers to keep staff who would otherwise have been made redundant on the books, this quarter's employment results show that many employees are being laid off nonetheless. Only at the worst of the Global Financial Crisis in mid-2009 has *Manufacturing Outlook* ever recorded lower figures, and it is quite plausible that if it were not for the job retention scheme we may have witnessed the worst employment figures in this publication's history.

Perhaps in anticipation of the furlough scheme being brought to an end in the coming months, manufacturers have indicated that their employment expectations for the next 3 months are for further redundancies. For many in the industry, restarting operations will not be straight forward. Resuming production in an environment where backup stocks have been sold off, headcount reduced, suppliers and customers are themselves also struggling, and when Government support may be being withdrawn, will pose a great challenge for even the most successful of companies.

Employment and Investment crash to levels not seen since the financial crisis

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↓ -22%	NEXT THREE MONTHS	↓ -36%
INVESTMENT	NEXT TWELVE MONTHS	↓ -26%		

Although this quarter's employment figures are hardly positive news, the longer-term worry for the sector lies in this quarter's investment intentions. At the start of the year, manufacturers reported increasing optimism about investment plans. After a couple of years of both political and trade uncertainty, business seemed poised to turn on the spending taps in 2020, something that had been sorely missed since 2016.

Now, unfortunately, we see the polar opposite in their plans, both as a result of the worsening economic outlook as well as firm level declines in cash reserves as a consequence of the costs incurred during the coronavirus pandemic. Not only is this investment essential to the UK's productivity and international competitiveness over the long term, but it will also be key to the industry's recovery in the short term.

Although, at this stage, substantial recovery is not impossible as manufacturers are keen to resume business. That, however, will be dependent on order books being restored which in turn will rely on the domestic and international economic environment. If orders pick up swiftly once the pandemic has passed, there remains the possibility that investment intentions may turn positive just as suddenly as they turned negative this quarter. Only time will tell.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	-16%	-17%	33%
Metal Products	-17%	-45%	-35%
Mechanical	-26%	-43%	-32%
Electronics	-25%	-17%	-12%
Electrical	-29%	-38%	-41%
Rubber & Plastics	-36%	-55%	-67%
TURNOVER			
£0-9m	-24%	-41%	-25%
£10-24m	-11%	-27%	-37%
£25m and over	-8%	-24%	-14%

Source: Make UK Manufacturing Outlook Survey.

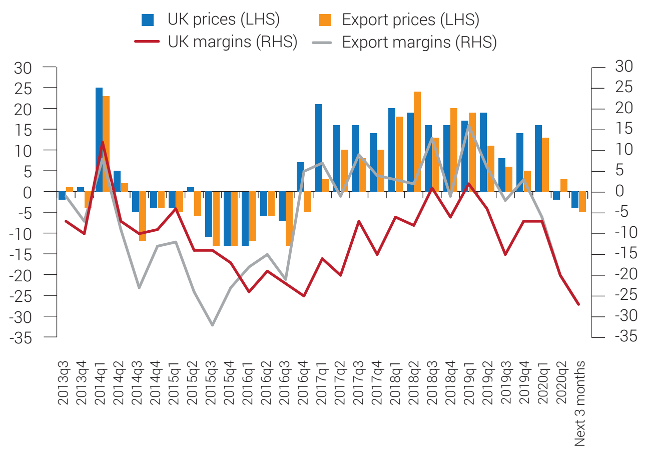
PRICES & MARGINS

Margins, as reported in our previous edition, were negative in Q1 2020, even prior to the current COVID-19 pandemic. The latest data shows that UK prices have now also declined on balance to -2%, the first negative result since the aftermath of the EU referendum in Q3 2016. Export prices remained marginally positive at 3%.

Unfortunately, both domestic and international margins collapsed to further negative balances as a combination of low prices and weak demand has hit profits hard since late March. Low domestic selling prices indicate that manufacturers are desperately trying to sell existing stock but there are proving to be paltry opportunities for profit. Crucially, the fact that export markets are also in lockdowns is making it increasingly difficult for firms to attract orders from international markets too.

Sharp fall in margins increases manufacturer's woes

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS ↓	-2%	NEXT THREE MONTHS ↓	-4%
EXPORT PRICES	PAST THREE MONTHS ↓	3%	NEXT THREE MONTHS ↓	-5%
UK MARGINS	PAST THREE MONTHS ↓	-20%	NEXT THREE MONTHS ↓	-27%
EXPORT MARGINS	PAST THREE MONTHS ↓	-20%	NEXT THREE MONTHS ↓	-27%

Unpromisingly, manufacturers' therefore expect prices and margins to fall further over the next three months.

In the last three months the European Brent Price of oil fell dramatically due to a global decline in demand and averaged approximately $26 per barrel, reaching a minimum $9 per barrel in mid-April. However, it is expected the low price of oil will be short-lived as countries that come out of their lockdowns first will inevitably increase demand for fuel. Moreover, for the most part, the Sterling-Euro exchange rate remained stable as the novel coronavirus impacted both the EU and UK. However, at the time of writing, the Sterling rate appears to be reacting negatively to news that the UK could end the EU exit transition period without a replacement UK-EU trade deal.

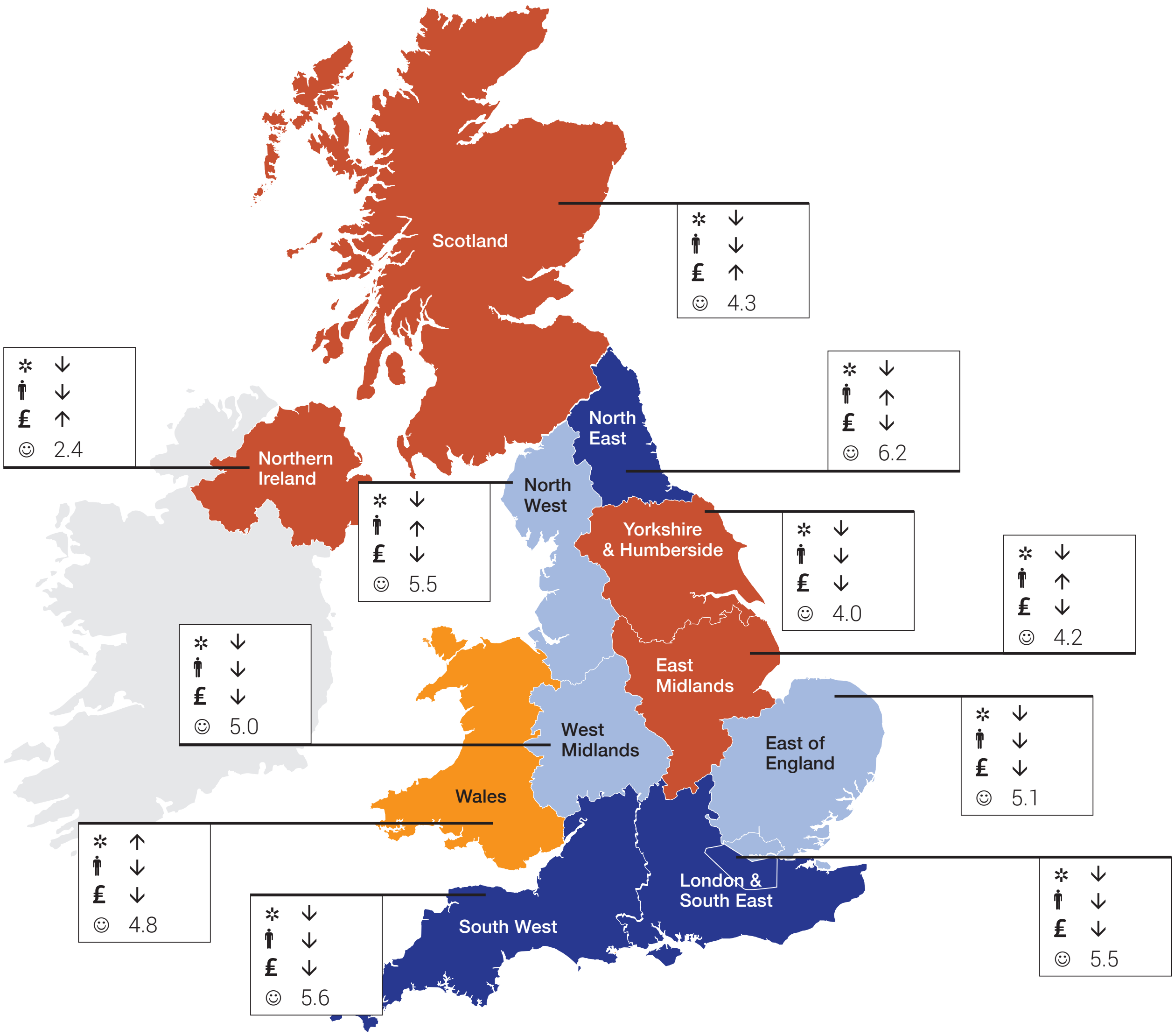
A mixed impact on subsectors

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

Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

Approximately half of the UK reported negative business confidence this quarter, with the other half only being marginally positive. So marginal is the positivity in these regions, all of which are in England, that there is only one region, the North East, which is a full point above the '5' inflexion mark. In most downturns, London and the southern regions have historically remained more confident than the rest of the country but the confidence levels reported amid COVID-19 are much more even between regions than is typical, an indication of the indiscriminate impact of the virus on industry across the UK.



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

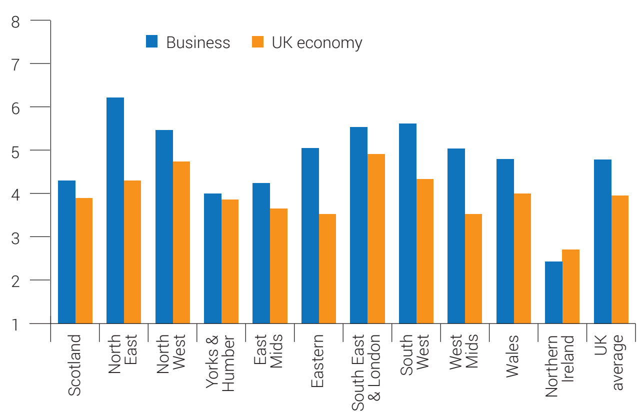
Northern Ireland and Yorkshire & the Humber reported the lowest business confidence this quarter, although it would be premature to conclude that the results in these areas are attributable to the performance of local businesses as opposed to the indiscriminate effects that the coronavirus pandemic has had on national and regional economies.

Manufacturing businesses have found it extremely difficult to maintain normal levels of production during the height of the outbreak as a result of a cumulation of issues related to staff not being able, allowed or willing to work, as well as the widespread disruptions caused to both domestic and international supply-chains.

As a result of this, it is somewhat unsurprising that the overwhelming majority of regions recorded a decline in confidence this quarter as well as falls in their output, employment, and investment intentions.

Firm-level confidence teeters on the edge of negativity, but confidence in the economy is very negative for the majority

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



Source: Make UK Manufacturing Outlook Survey.

UK ECONOMY CONFIDENCE

All nations and regions were unanimous in reporting low levels of confidence in the prospects for the UK economy. Confidence in the UK economy is almost always lower than business-level confidence, yet confidence scores are rarely unanimously negative. With the average confidence level for the UK economy at 3.95, it is clear manufacturers are concerned about a significant recession in the near future.

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	-58	-50	-54	-51	-26	-43
North East	10	-30	20	-10	10	10
North West	-60	-40	-65	-40	-10	-40
Yorks & Humber	-57	-75	-52	-60	-29	-60
East Mids	-43	-65	-29	-67	-10	-43
Eastern	-62	-35	-70	-24	-24	-43
South East & London	-31	-11	-23	-11	-17	-11
South West	-29	-21	-46	-21	-7	-36
West Mids	-28	-30	-28	-41	-21	-28
Wales	-10	-50	-10	-30	10	-20
Northern Ireland	-86	-100	-71	-71	-14	-43

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

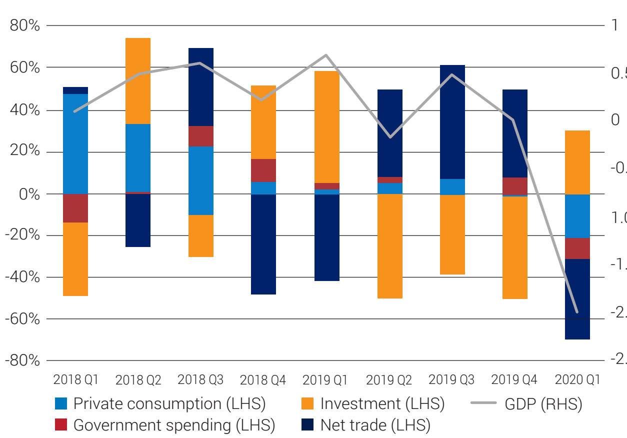
As a result of the coronavirus pandemic, the Bank of England (BoE) expects the UK economy to shrink by 14% this year, assuming social distancing measures end by September. This would be the sharpest annual contraction since 1706, but whereas the contraction of 1706 was caused by the concurrent challenges of the 13 year long War of the Spanish Succession and the financial costs accrued by the Treaty of Union after Scotland's failed Darien Scheme, the coronavirus implosion has happened in only a matter of months. There has never been a crash landing like this.

The Office for Budget Responsibility (OBR) forecasts a staggering unemployment spike of up to 10% – that is, 2 million additional people out of work. Crucially, the OBR's forecasts are built on the expectation of a rapid V-shaped recovery. However, as this report shows, insights from the manufacturing sector so far suggest that is unlikely. A quarter of manufacturers plan to make redundancies in the next six months and of those, more than a quarter plan to cut up to half their staff, and a third plan to cut up to a quarter of staff. As a consequence, a slower U-shaped recovery or a W-shaped double dip recession looks more probable.

As recently as the beginning of April, according to official statistics, UK unemployment across almost every measure was at all-time record lows. By the beginning of May, the government was directly paying the wages of nearly a quarter of the UK workforce when approximately 2.5 million people registered in one week for the COVID-19 furlough scheme. The total number of furlough claims now stands at 8.7 million and the Department of Work and Pensions (DWP) has reported another 1.8 million new Universal Credit claimants.

GDP declined by 2% in Q1 2020

Contribution to real GDP q-on-q growth



Source: ONS

Taxpayer subsidised short-time working will mitigate the surge in unemployment but the collapse in economic activity cannot be disguised. Government spending is now heading for its largest single-year deficit since the Second World War, with public sector net borrowing set to increase by up to £298.4bn this financial year.

Government borrowing surged to £62bn in April, the highest monthly figure on record meaning the deficit - the difference between spending and tax income - was larger last month than forecasted for the whole year when the Budget was announced just a few short months ago on the 11th of March. The OBR now estimates a revised deficit for the year of greater than 15% of GDP and state borrowing is now expected to exceed by more than five times the estimate at the time of the March Budget. By contrast, at the peak of the Global Financial Crash it reached just 11%.

The latest set of figures from the Organization for Economic Cooperation and Development (OECD) are equally gloomy suggesting annual growth across the group of 37 advanced economies, a reflection of evaporating demand from consumers and businesses, has slowed to such an extent that inflation dropped from 2.3% in February to 1.7% in March, the largest deceleration since the Global Financial Crisis.

While the hit to the UK economy has been unprecedented, with almost a third of manufacturing firms having seen their orders decline by up to 50%, not all sectors will be hit equally. The OBR says that manufacturing, construction, retail, travel, food industries, and education will see the biggest losses but social distancing restrictions or NPIs – Whitehall jargon for Non-Pharmaceutical Interventions – will have also disrupted the services sector in a manner that is likely to last for some time meaning the UK is now more reliant on manufacturers to lead the recovery. It is already notable how the ability to rely on manufacturing in this time of national emergency has proved vital.

The need for social distancing most directly impacts services such as retail, real estate, education, entertainment, and food & drink, where 80% of the UK workforce is employed. Inevitably, therefore, British retail sales plummeted by a record 18.1% in April as many stores shuttered up to stop the spread of the virus. Where high street shops have recently come under pressure from online competition the current downturn may lead to a permanent downsizing. Online consumption as a proportion of all retail sales reached a record high of 30.7% during the early lockdown. In many cases, shops, bars, restaurants, and hotels that have shut may not reopen.

Nor is the UK alone in its difficulties. Factories around the world have been forced to close or run on reduced hours, causing mass disruption to global supply chains. On January 23rd China was the first to initiate a lockdown. The latest official figures show its unemployment stands at 6.2%, the highest number since records began in the 1990s when the Communist Party reluctantly admitted joblessness was not a problem confined to the capitalist world. In the United States, the congressional stimulus package is by far the largest in US peacetime history. Fiscally conservative Germany has also declared an emergency and removed its limits on public debt, something it steadfastly refused to do during the Global Financial Crisis. Altogether, we are witnessing the largest combined Keynesian stimulus launched since World War II. As a consequence, the International Monetary Fund (IMF) has warned that net public debt could rise across the globe from 69.4% of national income last year to 85.3% this year.

Such monumental fiscal interventions have so far prevented a financial meltdown, but we now potentially face a protracted period in which falling consumption and investment drive further contraction. Discretionary expenditure is being deferred. Defaults and bankruptcies will likely increase. Consumer debt may surge.

Petrol consumption in Europe has fallen by 88% while in the US, oil prices amazingly plunged below zero in April for the first time in history as the pandemic hit demand.

The stringency of lockdown measures has varied from country to country but even those that tried to avoid shutting down have suffered immensely. Sweden is facing comparable economic pain to the rest of Europe despite, or perhaps because of, its much laxer lockdown restrictions. The Swedish Central Bank forecasts a downturn of up to 10% and unemployment as high as 10.4%.

In the developing world things look even worse. Of India's 471 million strong workforce, only 19% are covered by social security and two-thirds have no formal employment contract. Consequently, at least 100 million rural migrants have been forced to return to their home villages to seek help, a mass population transfer the likes of which has not been seen since partition in 1947. Though Sub-Saharan Africa has so far, officially at least, been hit relatively less by the virus in medical terms, the World Bank projects that it will be the region hit hardest in economic terms with an extra 23 million people pushed into extreme poverty and a further 16 million people in South Asia as well. This is the result of the remarkable fact that this year, for the first time since reasonably reliable measures of GDP were devised after World War II, overall the developing world economies will contract.

Back in the UK, on April 9th this country became the first to embrace the monetary financing of government to fund the immediate cost of fighting coronavirus, when the Bank of England agreed to a Treasury demand to directly finance the state's spending needs on a temporary basis. That this was even considered, and under a Conservative government too, is a measure of how extreme the current situation is. That the decision has so far produced little more than a shrug from financial markets is equally remarkable. The Bank's new Governor, Andrew Bailey, has also paved the way for negative interest rates in a dramatic move that illustrates concerns inside the central bank that the impact of COVID-19 will be longer and deeper than first anticipated. Such a move would be unprecedented in the Bank's 325 year history.

This is despite the fact that 95% of UK manufacturers have remained operational, at least in part. Firms have nevertheless been forced to reduce production while others have shifted to making much needed medicines, sanitizers, ventilators, PPE and other equipment for the health service to combat the spread of the disease. All the indications at the moment are that, even with a gradual easing of lockdowns, the impact of this shock will continue to be felt by firms and families for some time to come, and that's without a second or third wave of outbreaks.

Different parts of the economy will recover at different speeds, with export demands, consumer tastes and business models changing. Our biggest export market, the EU, has said it could be 2024 before its economies fully recover from the economic and trade effects of the COVID-19 crisis. Chancellor Rishi Sunak has made similar forecasts for the UK.

At the same time there is a growing coalition, including former Bank of England Governor Mark Carney and HRH Prince Charles, warning that while we can self-isolate from COVID-19 we can't self-isolate from climate change and calling for industrialised nations to invest in a green economic recovery. The deadline for the UK to agree on a deal with the EU is also fast approaching. So while the focus is on COVID-19, other concerns continue.

UK Economic Forecasts

% change except where stated

	2019	2020	2021
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.14	1.15	1.18
Exchange rate ($/£)	1.27	1.26	1.28
Exports	4.8	-13.4	8.5
Imports	4.6	-13.1	11.1
Current account (% GDP)	-3.9	-3.1	-3.5
OUTPUT			
Manufacturing	-1.5	-10	5.8
GDP	1.3	-8.2	7.0
COSTS AND PRICES			
Average earnings	3.5	-1.29	3.9
Oil price (Brent Oil $/bl)	64.4	37.8	44.4
EMPLOYMENT			
Manufacturing (000s)	2,711	2,535	2,637
Rest of economy (000s)	35,703	34,552	35,355
Unemployment rate (%)	3.8	5.8	5.0

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

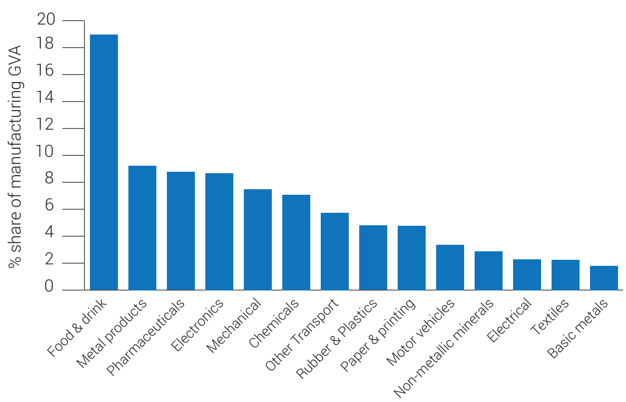
	GDP			INFLATION		
	2019	2020	2021	2019	2020	2021
US	2.3	-7	8.6	1.8	0.1	1.2
Eurozone	1.2	-7.6	6.2	1.2	0.2	1.5
France	1.3	-9.4	7.8	1.1	0.2	1.5
Germany	0.6	-5.9	5.1	1.5	1	1.4
Japan	0.7	-6	3.7	0.5	-0.4	0.1
China	6.1	0.8	8.5	2.9	2.9	1.6
India	5.3	-3	11.3	3.9	3.7	4.7
World (2015 PPPs)	3.6	2.9	-4	3.2	2.6	2.5

Source: Oxford Economics

SECTOR FORECASTS

Food & Drink sees temporary GVA boost amongst pandemic

Subsector share of Manufacturing Gross Value Added



Source: ONS

FOOD & DRINK

Not only has the **Food & Drink** subsector remained the UK's largest manufacturing subsector, but it has seen growth in its share of total manufacturing GVA this quarter as a result of two factors. Firstly, the reduction in contribution to GVA by other subsectors more impacted by the lockdown. Secondly, the domestic food & drink industry in the UK has retained robust output levels to meet the sudden spike in demand for domestically produced food & drink products. This demand is in the form of increased consumer preference for domestically manufactured goods as restaurants and other Food & Drink retailers have ceased trading, but it is also due to the international freight back-log that has made domestic sources more important. However, this trend is expected to be short-lived, with output and demand for domestic products likely to fall back to normal proportions once international stocks stabilise.

ELECTRONICS

The **Electronics** subsector had enjoyed strong growth in output in 2019, although 2020 was looking down even before the pandemic struck. COVID-19 has exacerbated the existing difficulties in obtaining semiconductor and passive components. This challenge remains a significant obstacle for UK Original Equipment Manufacturers (OEMs), with many businesses continuing to report difficulties both in being able to supply existing products and in bringing new products to market. The issues manufacturers raised at the start of the year with regard to product allocation and product obsolescence have only worsened because of the pandemic. Previously manufacturers expected that global component shortages would dampen the subsector's output for the next 9-12 months, with the new challenges that the pandemic has placed on the international economy, this reality will be a more protracted affair.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector typically finds its outlook is strongly linked to the performance of the companies that consume its products down the supply chain. Decreasing demand from particularly the automotive, aerospace and construction industries has meant steel orders have faded. Many UK automotive firms have also switched to making PPE to help the NHS. Cash flow is currently a concern for almost all manufacturers but many basic metals companies in particular have experienced difficulties accessing appropriate finance to weather the effects of the pandemic. However, recent indications from major automotive manufacturers, amongst other metal-input production industries, that production is soon to restart in some form, means demand is expected to return gradually.

The **Fabricated Metals** subsector is suffering many of the same consequences of the pandemic as the Basic Metals subsector, particularly in regards to demand. Sitting one step away from the raw metal production still leaves the subsector exposed to the drop off in demand from key metal-input subsectors such as the aforementioned automotive and aerospace industries. The reduction in both global and domestic construction activity will have also filtered through into a loss of demand, and in turn output, for the subsector. However, it is expected that the majority of major construction projects will be resumed once the pandemic has passed, and so there is a strong indication that existing business has not been necessarily cancelled, but rather paused.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector has unfortunately seen its output performance go from bad to worse. After being one of the worst-performing subsectors in terms of output growth in 2019, now in Q2 2020 we expect another decline in output, the second-worst decline of the subsectors we track. A large reason for this decline in 2019, and our low expectations for 2020, is the stagnant investment outlook. The performance of the Mechanical Equipment subsector is closely associated with overall manufacturing investment spend. Throughout 2019, investment intentions were never realised as companies kept their purse strings tight while they awaited clarity on the future political and trading position of the UK. Now with the pandemic suppressing investment levels to new lows, it seems as though the Mechanical Equipment subsector is not going to benefit from increased investment spending any time in the near future.

TEXTILES

The **Textiles** subsector is expected to endure a decline in output in 2020 by -19%, approximately twice as severe a drop as is expected for the manufacturing industry as a whole. Even with this decline in output, employment figures are, somewhat fortunately, only expected to decline in line with the manufacturing average, at -8.2%. Recovery to pre-coronavirus levels is also likely to take some time, particularly for those domestic manufacturers who produce homogenous products that customers could easily substitute with overseas goods. Increasing competition from East Asia, in large part because of labour costs, means Textiles manufacturers in the UK are having to specialise more in the high-end and luxury categories. Unfortunately, high-end and luxury goods typically see the worst drops in demand during economic downturns.

PAPER & PRINTING

The **Paper & Printing** subsector is expected to see a below-average contraction in its output in 2020, implying that it will fare relatively better than most subsectors in the short-term. However, it remains another subsector that faces tough competition from abroad and has to constantly offer quality at prices that may sometimes push below the marginal costs of the domestic producer. Nonetheless, increases in the demand for the subsector's products during this pandemic have not been insignificant. The coronavirus has caused huge spikes in postal, and ready-meal delivery and supermarket products but also consumer preference changes that resulted in increased demand for plastic packaging rather than paper based materials. The impact of this trend will depend on both business and consumer behaviour and whether the desire for the convenience of more sub-divided and packed goods continues.

ELECTRICAL EQUIPMENT

With above the manufacturing average declines in both employment and output in 2020 for the **Electrical Equipment** subsector, the outlook is a negative one. The subsector's key customers lie in the construction and aerospace industries, which have both largely paused production. This has resulted in a significant drop in demand for Electrical Equipment. However, longer-term domestic infrastructure projects still hold hope for future demand in the subsector, with electricity grid upgrades and internet connectivity projects holding the power to stimulate renewed output growth in the subsector.

NON-METALLIC MINERALS

The greatest downward pressure on the **Non-Metallic Minerals** subsector (bricks, glass, and mortar) is the evidence of abysmal levels of construction activity in the UK. UK Construction PMI fell to 8.2 in April, indicating historically low levels of construction equipment purchasing, which reflects reduced demand and output for the Non-Metallic Minerals subsector. We expect this to have significant negative consequences for employment in the subsector in 2020 overall. As is the case with other subsectors that are closely linked with the construction industry's performance, demand is likely to pick up once construction activity resumes.

PHARMACEUTICALS

As a result of the coronavirus, **Pharmaceuticals** is the only subsector in this edition of *Manufacturing Outlook* to buck the trend of negative output. We expect growth in output for the subsector over the year, and a small boost in employment as firms take on staff to cope with the rising level of demand. As a result, the outlook for the subsector in this quarter is relatively positive, but with the caveat that the current performance of the subsector is a reflection of the current pandemic rather than a permanent trend change.

CHEMICALS

The **Chemicals** subsector performance this quarter has been negative, but somewhat less severe than the average decline endured by other subsectors. Going forward, output is expected to decline only about a third of the average, but employment falls are expected to be in line with the rest of the manufacturing sector. What has helped the Chemicals subsector during the pandemic has been HM Government's easing of regulations to allow certain companies to bring new products to market quickly, enabling these firms to meet urgent, short-term, demand. New products categorised as PPE have also received special dispensation, having been allowed a fast track through the typical safety procedures. As a temporary measure, products without a CE marking have been allowed onto the market, provided they meet minimal safety requirements. These regulatory holidays have benefitted all Chemicals manufacturers, but have brought significant benefits to those who are able to use them.

RUBBER & PLASTICS

For the **Plastics** industry, independent of the current coronavirus pandemic, the long term decline in consumer preference for single-use plastic goods continues. The British Plastics Federation has reported that 80% of firms expect to see their turnover decrease in the next six months. Short-term demand for plastic products in the form of PPE and packaging has been high. However, for those not already specialising in the production of PPE, the benefit individual firms have experienced from this uptick has depended on their ability to quickly switch production to make new types of plastic products.

In the **Rubber** subsector, the tyre market accounts for the lion's share of domestic demand. With automotive sales plummeting by a whopping 99.7% in April, demand has been so weak that there have been some notable large tyre producer closures. However, large national garage networks have reported an increase in consumer tyre fittings, likely a result of the move away from public transport. Overall, output for the **Rubber & Plastics** subsector is expected to decline about half the average, but employment is expected to decline just over the average.

MOTOR VEHICLES (AUTOMOTIVE)

The **Motor Vehicles** industry has suffered the steepest decline of any subsector this year, and this trend looks set to continue with our expectation for a decline in output of more than three times the average. The cause of this massive drop steams from the multiple factory shutdowns that took place as the pandemic gripped the domestic economy. Indeed, JLRs Castle Bromwich plant has already stated publicly that it will remain shut until at least mid-August. There are typically over 30,000 individual component parts in any single car. The subsector's highly complex, and international, supply-chains means that when international freight was disrupted due to the COVID-19 outbreak, many motor vehicle manufacturers could not source all the parts required and, with no means of using an alternative producer, if one part is missing no car gets made. Nevertheless, we do expect significant positive growth in output in 2021 as the Motor Vehicles industry compensates for the lost time in 2020.

OTHER TRANSPORT

Primarily composed of defence, aerospace and shipping industries, the **Other Transport** subsector is historically robust, but reliance on long lead order books has created significant problems for the subsector during the coronavirus crisis. Beyond the struggling OEMs, many highly specialised intermediate companies rely on troubled up-stream customers such as Boeing and Airbus which are, in turn, struggling to find customers for their respective products. For intermediate firms in this highly specialised subsector often the majority of their order book comes from a small number, or in some cases just one, customer. Overall this leads us to forecast a worse than average decline for output in the Other Transport subsector but, assuming the fall in air passenger numbers is reversed, we expect a degree of bounce back in 2021 as backorders are filled.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2019	2020	2021	2019	2020	2021
Basic metals	-3.5	-17.3	7.4	1.4	-11.2	2.0
Metal products	0.1	-6.6	2.3	3.1	-8.5	2.6
Mechanical	-5.3	-20.2	6.3	2.5	-7.1	1.7
Electronics	2.4	-4.2	3.7	-0.6	-3.7	-1.2
Electrical	3.8	-11.7	4.7	3.7	-14.5	7.0
Motor vehicles	-7.1	-34.3	49.8	3.1	-16.4	-2.1
Other transport	-1.2	-14.9	8.2	0.8	-8.2	-0.7
Food and drink	2.4	-0.2	3.4	2.1	-4.5	6.7
Chemicals	-0.5	-3.7	2.1	3.4	-6.3	6.0
Pharma	4.2	2.9	-1.3	1.0	12.4	1.3
Rubber and plastics	-1.9	-3.2	3.7	-1.8	-7.9	8.4
Non-metallic minerals	-5.9	-7.0	4.2	3.7	-12.8	1.0
Paper and printing	1.2	-8.7	3.2	-2.5	-10.0	6.0
Textiles	1.3	-19.1	1.4	-1.5	-8.2	4.3
Manufacturing	-1.5	-10.0	5.8	0.4	-7.3	3.9

Source: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

MANUFACTURING IN A NEW WORLD THROUGH DIGITAL TRANSFORMATION

Over the decades manufacturers have overcome numerous challenges to remain a key part of the UK economy. In recent months, they have again stepped up to support the country through COVID-19, be it through the ventilator challenge, switching production to manufacture PPE or working at full tilt to restock supermarket shelves.

COVID-19 is creating significant disruption for manufacturers and this is clearly reflected in our Q2 survey results. In stark contrast to the confidence and investment highs we saw in Q1, these have sharply dropped along with output and orders – falling to levels comparable to the financial crisis.

Manufacturers have been forced to change the way they operate – from addressing sudden changes in demand, reconfiguring their factory floors to ensure staff safety, to sourcing new suppliers due to disruptions in global supply chains. All this has meant production for some manufacturers has stopped, slowed or for some significantly increased.

Manufacturers navigating this challenging environment will need to emerge stronger, rethinking their ways of working to succeed in the new world. In our view, one area of focus should be digital transformation.

The Fourth Industrial Revolution and digitalisation are fundamentally changing the way many manufacturers operate, communicate and manufacture goods. Yet to date, the take up within UK manufacturing has only been moderate. COVID-19 has however highlighted the need for manufacturers to pick up the pace to allow improved electronic communications through the supply chain to drive further efficiency gains and productivity. The data generated through greater connectivity will provide manufacturers with invaluable supplier and market information and greater flexibility to pivot during times of change and challenge.

In our digital transformation survey, manufacturers clearly understood the benefits of investing in digitalisation and recognised that these extend beyond the factory floor to back-office support functions and supply chains.

Since the spread of COVID-19, manufacturers' supply chains have been hit hard. Greater visibility through digital transformation connectivity would allow businesses to respond quicker to expected supply chain disruption and enable them to track orders and delivery times.

In addition to this, greater connectivity with customers will provide better insights into their buying behaviours and changing requirements, again allowing a faster response to changing circumstances and needs.

In uncertain times major investments in robotics and AI may not necessarily represent the best value for money for the typical manufacturer seeking to digitalise their businesses. Starting small is often where the value proposition is clearer. More modest first steps like ensuring your CRM and ERP software is up to date can improve productivity without the need to invest millions in major projects.

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.

The government recently paid tribute to the work manufacturers have done to keep the UK economy going during the pandemic. There is no doubt that once the UK emerges from the COVID-19 pandemic, the sector will need the government to help support the significant change and high levels of investment that will be required for businesses to embed greater digitalisation.

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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

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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

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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**

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