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MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2020 QUARTER 4

With support from:

Scottish Engineering and Manufacturing NI

FOREWORD

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As the nation begins to emerge from the plight of the pandemic it becomes ever more apparent that history, particularly economic history, does indeed have a tendency to repeat itself. Once again, the manufacturing sector in the UK finds itself shouldering the brunt of this repetition, a cruel déjà vu of an occasion but a decade passed.

The means by which manufacturers found themselves in yet another crisis not only vary significantly, but are also of little importance to those enduring businesses in the UK where the resulting circumstance tasks them with the immediate challenge of keeping the gears of industry turning. Of course, the day-to-day challenges faced by UK manufacturers in the Global Financial Crisis and the Coronavirus Pandemic differ in nature, but it is upon the industry's emergence from these national crises that this same battle begins anew.

Between 2007 and 2009, the manufacturing industry in the UK experienced a decline in output of 11.7%. Even over two years, this degree of decline might have then been considered to be the death-knell for an industry that had been in technical decline for quite some time, with the trade surplus in manufactured goods having evaporated back in 1983. While a 'v-shaped' recovery in the sector was decried by virtue of a 4.2% increase in output between 2009 and 2010, in truth, manufacturing output never regained the ground it lost to this day, although it came excruciatingly close in 2019.

Such is the exceptional misfortune that has been rendered upon a sector that had spent the decade following the Global Financial Crash toiling steadily toward pre-Crash output levels, against the odds in both a trading and policy environment that had been specialised to the benefit of the services sector by successive UK governments, to find that within the space of a single quarter output levels would sink twice as severely as the prior crisis at the inception of UK's Coronavirus ordeal.

Now at the end of 2020, with the *single* year's total manufacturing output expected to decline by 12%, the path ahead appears to be filled with even greater challenge than what came before.

Yet, despite the protracted onslaught on manufacturing's designs on prosperity, the industry perseveres in substantial form, and continues to contribute indispensably to both the UK economy and the quality of life of its inhabitants. Average wages in the sector are 13% higher than the national average, with every job contained within creating an additional 1.4 jobs for the country. 65% of all UK research and development is carried out by manufacturers, and just over half of all exports are manufactured goods.

Make UK and BDO's latest *Manufacturing Outlook* details the perilous recovery the sector is undergoing, with tempered increases in most metrics leading to a guarded optimism for progress in 2021. There is little doubt that the UK's imminent departure in earnest from the EU will sully the trading outlook at the start of the new year with the sector's largest international customer, but deliverance for the sector will truly come from the long yearned-for renewal of partnership between itself and Government, prioritising the creation of the conditions necessary for long-term success.

Critical to this goal will be the partnership's focus on skills, digitalisation and capital, to name but a few. From this crisis, the wounds now laid bare, there lies a genuine opportunity to re-balance the focus of Government toward the merits of a prosperous domestic manufacturing industry, and despite the inevitability of history's repetition, perhaps now with the potency of hindsight we can endeavour to maximise our potential.

HEADLINES

Make UK's Q4 2020 Manufacturing Outlook report, in partnership with BDO, updates on the record-breaking lows reported earlier this year due to the COVID-19 pandemic.

Last quarter the survey reported significant improvements in output and orders as manufacturers benefitted from reduced restrictions and greater knowledge of how to navigate the new business environment. However, the balances reported in Q3 2020 were still some of the lowest reported by historical standards.

The latest results indicate manufacturers have continued to report improving, or at least not worsening, levels of performance across the majority of metrics. However, firms expect their orders books, particularly international sales, to worsen over the coming months as the UK-EU transition period ends.

As the UK leaves its second national lockdown, and continues to wrestle with a tiered approach to restrictions, the output balance reported at -5% for Q4 2020. A figure that is still concerning due to its negative nature, but substantially improved on the previous quarters' -36%. A portion of the upward movement in output is also explained by last-minute stockpiling taking place to some degree as we near the end of the transition period.

UK orders have remained negative since the third quarter of 2019. However, in line with other metrics, the UK order balance improved to -5%. The export order balance also reported at -5%. Although these figures indicate an overall contraction in the industry, they are more positive than last quarter meaning a larger proportion of the industry's performance either improved or did not worsen. Contrary to last quarter, the order balances are expected to worsen. This is primarily due to the uncertainty associated with the UK's negotiations with the EU which has also downgraded manufacturer's expectations for export margins.

An unexpected extension of the Job Retention Scheme (JRS) combined with the fact that most redundancies have already been executed has resulted in the employment balance improving on its Q3 performance. However, a balance of -14% is still one of the most negative in recent years signifying the extension of the JRS has mainly delayed job losses into 2021.

The investment intentions balance reported at -11%, remaining at shockingly low levels as many businesses this year had repurposed what little cash they could muster for short-term business continuity. This was partly done to avoid taking on too much debt, although debt levels are expected to rise to unsustainable levels anyway over the coming years.

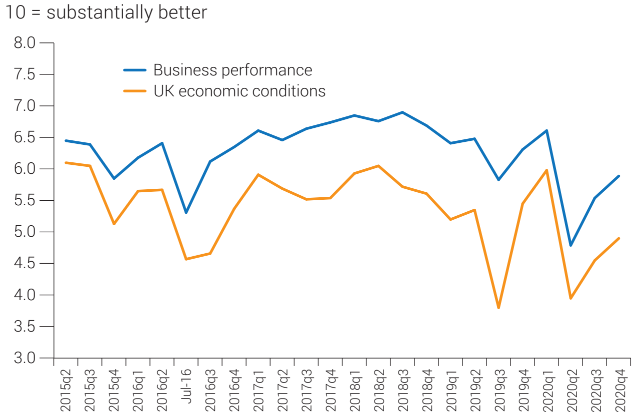
Business confidence has continued to steer further upwards into positivity. This is likely down to the idea that the UK, regardless of the severity of the situation today, is in a much better place than in Q2 2020 – the height of the pandemic.

INDICATOR	BALANCE	CHANGE	
Confidence	5.9	↑	Business confidence increased slightly
Output	-5%	↑	Output balance trends upwards but remains in negative territory
UK orders	-5%	↑	UK order balance trends upwards but remains in negative territory
Export orders	-5%	↑	Export order balance trends upwards but remains in negative territory
Employment	-14%	↑	Employment balance improves as job losses decelerate
Investment	-11%	↑	Investment intentions improves but remains in deep negative territory

Source: Make UK Manufacturing Outlook Survey

Confidence continues to pick up following Q2 crash

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

Make UK's previously released Q2 *Manufacturing Outlook* survey reported the lowest balance of output since 1998. The -56% balance for output indicated a contraction in the industry that outweighed the decline in activity seen during the 2008-2009 crisis. Since then the industry has failed to achieve its expectations of a quick recovery due to a combination of the second wave of infections, extended lockdowns and trade uncertainty. The latter of which has resulted is stockpiling to some degree, although not to the levels seen in early 2019.

This quarter's survey covers the period in which lockdown restrictions were significantly eased in the UK, as well as the implementation of lockdown 2 followed by an extension of the Job Retention Scheme. However, given manufacturers are not required to shut it is assumed the impact of these announcements on output and orders will be minimal in the short-term. Nevertheless, a prolonged period of reduced activity will impact firms that are open for business too.

The latest survey reports similar trends for individual subsectors. However, there have been some standout performances for a few that have bucked that trend.

Firstly, Basic Metals reported a positive output balance of 8%, following a very low -75% balance. Although still negative, the Metal Products output balance also improved to -7% from -19%. Indicating both extractors of raw metals and fabricators of metals are benefitting from better demand conditions from downstream sectors, such as Automotive and Construction.

Both the Electronics and Electrical Equipment subsectors reported positive balances of 6% and 17% respectively, bucking the trend of the UK average. Both of these subsectors cater to the components and equipment for automation technologies, as well as household appliances. Of which the latter has seen a boost in demand due to a rise in home working employment. However, the Mechanical Equipment subsector remains in negative territory, although the output balance for these firms has improved for similar reasons too.

PAST THREE MONTHS ↑ -5% **NEXT THREE MONTHS** ↑ -3%

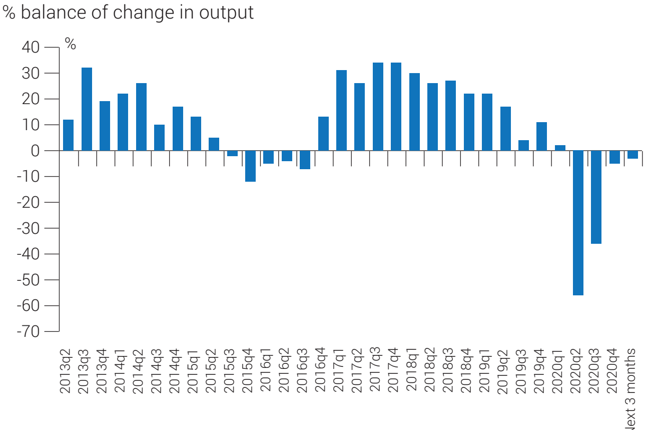
As such, the latest *Manufacturing Outlook* survey for Q4 2020 reported an output balance of -5%, up from -36% last quarter.

The latest output balance is close to what manufacturers forecasted last quarter -7% underlining that UK firms generally have strong foresight of the coming quarter. However, although the trend towards positive balances is expected to continue, UK manufacturers expect to remain in slightly negative territory for Q1 2021.

Rubber and Plastics is one of the few key material subsectors that reported a worse output balance this quarter. This is likely due to a combination of reduced activity associated with lockdown 2 as well as stabilising demand conditions for plastic and PPE products.

Output continues to trend upward but will stay negative for the remainder of 2020

% 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	8%	8%
Metal Products	-7%	-15%
Mechanical	-12%	-3%
Electronics	6%	0%
Electrical	17%	6%
Rubber & Plastics	-20%	-40%
TURNOVER		
£0-9m	-9%	-5%
£10-24m	-1%	-14%
£25m and over	34%	27%

Source: Make UK Manufacturing Outlook Survey

ORDERS

In line with the change in balance reported for output, the latest survey indicates orders have moved in a similar direction since Q3 2020. The latest figures are by far a significant improvement from the lows reported in Q2 2020 which illustrated how vulnerable supply-chain networks are globally. However, the balances for both domestic and international orders remains negative on balance.

The latest survey reports the total order balance at -3%, up from -40% last quarter.

UK ORDERS

UK orders improved to -5%, the result indicates on balance the share of manufacturers that experienced a worsening of domestic orders continues to shrink.

Worryingly, the UK orders balance has now been negative for over a full year suggesting, despite the occasional upwards movement, demand for goods sold domestically has been contracting since well before the pandemic. Even more so concerning is that the balance for UK orders is negative during the festive season, which traditionally affords a seasonal boost to orders. This is true for exports also.

UK ORDERS	PAST THREE MONTHS	↑	-5%	NEXT THREE MONTHS	↓	-7%
EXPORT ORDERS	PAST THREE MONTHS	↑	-5%	NEXT THREE MONTHS	↓	-14%
TOTAL ORDERS	PAST THREE MONTHS	↑	-3%	NEXT THREE MONTHS	↓	-5%

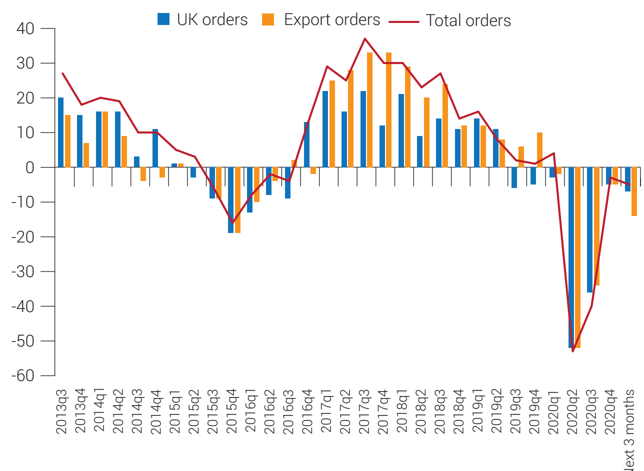
Different to the results for output, expectations for orders across the board are not only negative but predicted to get worse next quarter. Like most cases, this is due to a combination of increased national restriction measures as well as trade uncertainty on EU negotiations. These figures are concerning as UK manufacturers have recently forecasted their performance to near accuracy over the next quarter indicating they could be right again for Q1 2021.

As before, the remainder of 2020 will be crucial to the UK's post-pandemic recovery as negotiations with the EU, as well as other countries, continues and the details of which still remain in the air. However, recently announced plans by the Government to invest in a green recovery will benefit the domestic markets but the manufacturing base must not be significantly weakened so much that it is unable to deliver on these ambitions. Therefore, the sooner the details of trade deals are clarified the sooner manufacturers can adjust their business processes.

However, these concerns are not spread equally between different subsectors. As reported in the data for output, UK orders have indicated a mixed response for industry. In summary, most major subsectors have reported a relative improvement on orders following the lows in Q3.

Manufacturers expect exports to worsen amid trade uncertainty

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

Basic Metals reported an improved -8% balance following the abysmally low -88% previously. However, expectations for next quarter are even more optimistic as a balance of 25% of Basic Metal manufacturers predict UK orders will increase. Due to the close network between Metal Products and Basic Metals, the former followed a similar trend although they expect domestic sales to be flat next quarter.

The Electronics subsector is known to be a significant benefiter of the boost in demand generally seen as a result of Christmas. Although the balance is not significantly up, it is one of the few subsectors to have a positive domestic order balance. As a consequence of the strong performance of Electronics, Electrical Equipment has similarly benefitted from greater demand for automation, fibre optic and consumer technologies.

EXPORT ORDERS

Export orders reported a balance of -5%, a marked improvement on Q3 2020's -34%.

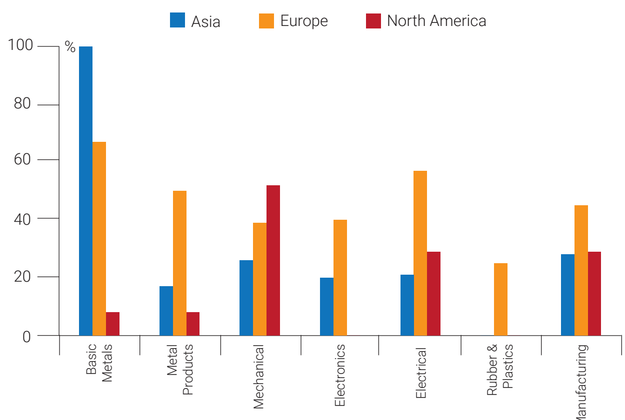
Despite the improvement, which is in line with trends observed elsewhere, the expectations for exports are quite dire amongst UK manufacturers. Firms forecast a balance of -14% for Q1 2021, a prediction relatively much more negative than expectations for domestic orders. This is best explained by the approaching end to the transition period between the UK and EU which has led manufacturers to become more pessimistic about trading freely with their most important market.

Subsector wise, almost all key subsectors (excluding Electronics) predict orders books to dry up further internationally.

As expected the EU remained the main market where manufacturers reported positive demand conditions. This quarter firms have indicated North America as once again the second-best location for positive demand conditions, although it is closely followed by Asia too.

Businesses see similar demand conditions in Asia and North America

% 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	-8%	25%	9%	-27%	-25%	17%
Metal Products	-3%	0%	-10%	-32%	-3%	10%
Mechanical	-14%	-9%	-2%	-14%	-9%	-13%
Electronics	0%	0%	-14%	21%	6%	13%
Electrical	11%	-11%	0%	0%	28%	11%
Rubber & Plastics	60%	-40%	-25%	-25%	40%	-60%
TURNOVER						
£0-9m	-9%	-11%	-13%	-17%	-9%	-8%
£10-24m	-8%	-6%	-17%	10%	-3%	-11%
£25m and over	24%	15%	33%	-11%	35%	13%

Source: Make UK Manufacturing Outlook Survey

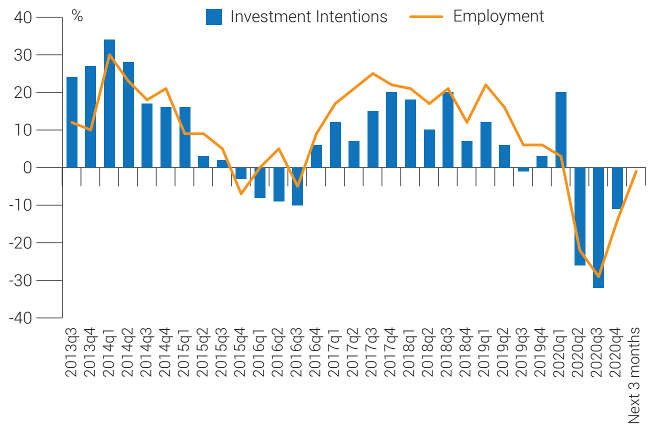
EMPLOYMENT & INVESTMENT

The surprise extension of the Government's original Job Retention Scheme (JRS) will have a strong bearing on the employment outlook in the UK manufacturing sector in the fourth quarter of this year and into the start of the next. For the optimist, the extension of the scheme will allow cash-strapped companies the breathing space they need in order to develop a stronger business footing to emerge from the pandemic-induced crisis in the best position possible. For the pessimist, the extension to the scheme will see the inevitable increase in unemployment kicked down the road and into the next year.

Such is the Office for Budget Responsibility's (OBR) take on the matter, as they have forecast for unemployment to peak in the second quarter of the next year. However, the OBR's forecast covers the entire UK economy, not just specifically manufacturing. Current indications are that industries with the grimmest outlook for employment are those which have not been able to trade in any, or extremely limited capacities, during national lockdowns, such as hospitality and leisure.

Investment and employment intentions improve for the first time since Q2

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑	-14%	NEXT THREE MONTHS	↑	-1%
INVESTMENT	NEXT TWELVE MONTHS	↑	-11%			

The manufacturing industry, and the employment contained within, is structured differently to other industries in the economy, and as such has been affected by the pandemic in similarly different ways. While our latest fourth quarter research into manufacturing employment in the UK shows a marked uptick compared to the negativity last quarter, it still remains in historically deep negativity. However, the silver lining lies within manufacturers' expectations for the next quarter, which predicts an end to the bleed of jobs in the sector, within a margin of error. Many manufacturers have already completed their redundancy processes, and are moving forward with established staffing plans going into 2021. Based on this, and with what manufacturers are reporting to be their employment expectations in the coming quarter, we can expect not to see such a severe opening of the unemployment floodgates in the sector once this extension to the JRS wraps up by the end of Q1 2021.

With not only the pandemic to grapple with, but the uncertainty around the imminent new future trading relationship with the EU to tackle, it's no surprise that investment intentions remain, since the start of the pandemic, at their worst level for 29 consecutive quarters. With little pent-up cash for capital expenditure, as in many cases it has already been disposed of in the pursuit of business continuity, it may be some quarters before we see the investment balance figure creep back into positivity. Nevertheless, the upward trend is a positive, albeit sluggish, indication that investment in the industry is moving in the right direction, with this quarter's balance of change figure approximately half as negative as it was last quarter.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	-8%	0%	-17%
Metal Products	-10%	-7%	3%
Mechanical	-13%	-8%	-15%
Electronics	-6%	27%	7%
Electrical	6%	6%	-6%
Rubber & Plastics	0%	0%	-50%
TURNOVER			
£0-9m	-19%	-9%	-8%
£10-24m	-18%	-5%	-19%
£25m and over	-6%	10%	-3%

Source: Make UK Manufacturing Outlook Survey

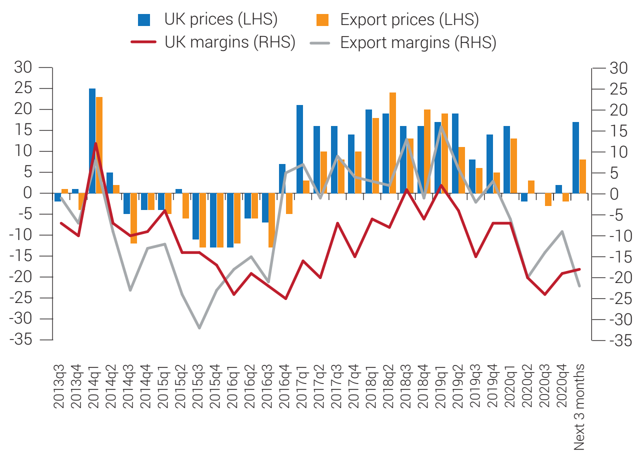
PRICES & MARGINS

In the last five years domestic margins have reported negative balances for a total of 22 different quarters. The difficulties of turning a profit for UK manufacturers has been a known problem for many years, especially given that the majority of the sector is built around SMEs. Low margins can also partly explain the barriers some small firms face when they desire to expand. There is a similar trend observed for export orders too, yet historically speaking margins are not as bad internationally. Nevertheless, the latest survey indicates margins remain negative for Q4 2020 but have improved in comparison to the previous quarter suggesting businesses have benefitted somewhat from eased restrictions.

Furthermore, the latest survey shows that a balance of 2% of manufacturers have reported UK prices to have increased despite low inflation. This is explained by the increase in demand for Electronic goods this quarter which reported the largest positive balance (27%) of manufacturers seeing an increase in domestic prices. In contrast, export prices remain in a negative balance partially dominated by downward pressures originating from Basic Metals and Chemical goods.

Domestic prices trend up but margins remain in negative territory

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑	2%	NEXT THREE MONTHS	↑	17%
EXPORT PRICES	PAST THREE MONTHS	↑	-2%	NEXT THREE MONTHS	↑	8%
UK MARGINS	PAST THREE MONTHS	↑	-19%	NEXT THREE MONTHS	↑	-18%
EXPORT MARGINS	PAST THREE MONTHS	↑	-9%	NEXT THREE MONTHS	↓	-22%

Over the next three months manufacturers expect prices and UK margins to improve but export margins to worsen.

The European Brent Price of oil averaged approximately $40 per barrel ($1 greater than last quarter) as households leaving lockdown increased their consumption of petrol and diesel fuel. However, oil prices remain low by recent standards and the lack of demand for air travel is depressing the value of jet fuels. Nevertheless, it is unlikely high oil prices will return anytime soon particularly as supply is abundant and, currently, it does not appear that OPEC will limit production to raise the price of oil.

The Sterling-Euro exchange rate averaged around €1.1 in Q3 2020 according to the ONS. Additionally, the rate continues to tie its movement closely with news stories around UK-EU trade negotiations.

Export prices rising for Electronic goods

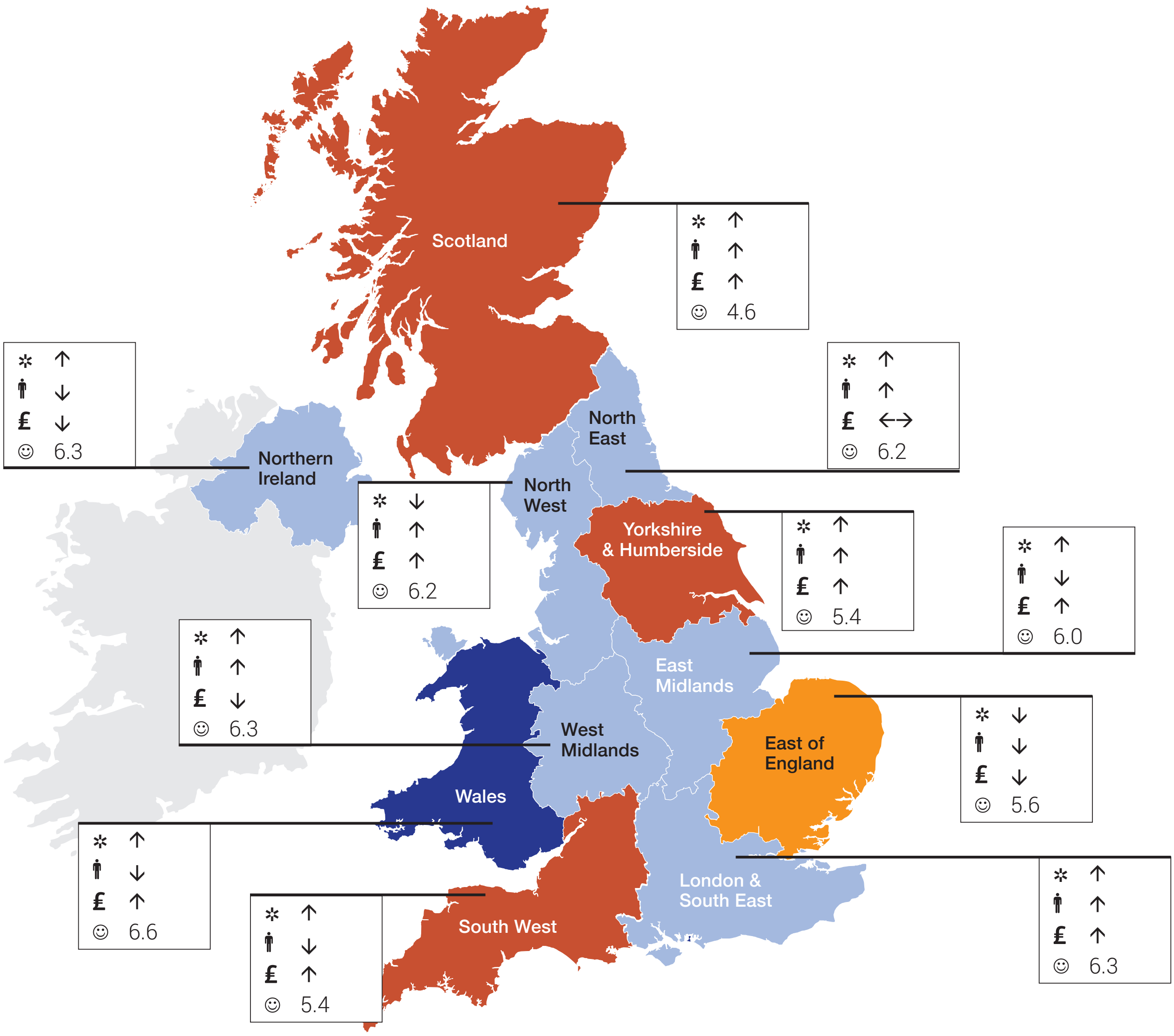
% balance of change in export prices in the past three months

Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

All regions and nations have reported a slight improvement in their business confidence in the fourth quarter of 2020, the exceptions to this are the East Midlands, East of England and South West regions, which experienced an equally slight decline in their business confidence. Average business confidence in the UK manufacturing sector stands at 5.9, an improvement of approximately 0.4 points.

Confidence is one of the metrics that has remained the most positive consistently throughout the pandemic, which



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

is a good indication for the staying power of the industry. Once again in the fourth quarter, all regions and nations report a positive confidence value (i.e. above the '5' inflexion point) apart from Scotland. It must be noted, however, that the confidence measurement in Scotland follows a slightly different survey elicitation method, which means Scottish confidence values should only be compared with other Scottish confidence values.

The largest positive shift in confidence this quarter was observed equally in Wales and Northern Ireland (NI), which may well be a signal that the longer-term prospects for manufacturing in these nations are changing for the better, as these two nations over the past years have on average, reported worse general manufacturing economic performance metrics than their English counterparts. However, both Wales and NI attract small sample populations in our surveys, and therefore the results may not be representative across their entire industry. The deepest decline (a change of -0.7) in confidence occurred in the East Midlands region. The East Midlands' regional economy is highly geared towards manufacturing, and so we can often see larger shifts in confidence when the economic circumstance for the industry changes in this region.

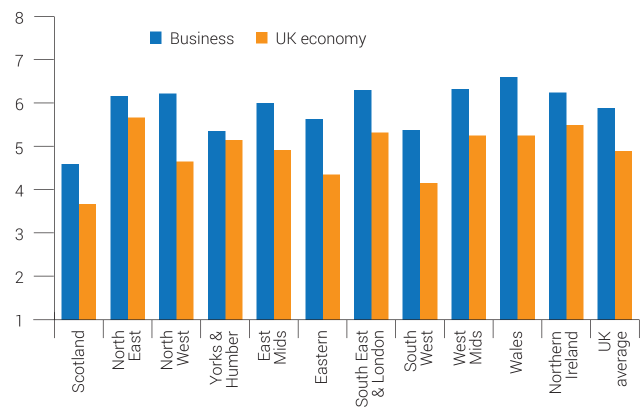
The overall increase in confidence this quarter reflects both the position manufacturers find themselves in currently, which in almost all cases is operational to at least some degree, and their expectations for the next quarter being significantly more positive than this one. Nonetheless, although these expectations indicate an improvement next quarter on this quarters figures, balance figures are still expected to remain negative so the industry is unlikely to enjoy positive balance figures at the start of the New Year.

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 improved by approximately 0.4 points compared to last quarter, standing at 4.9. If the trend in improving confidence continues into next year, we would expect to see an above '5', confidence reported for the UK economy, finally indicating a positive outlook for the economy as a whole.

A more positive picture for Regions' performance compared to the previous quarter

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



Source: Make UK Manufacturing Outlook Survey.

Regional summary

% balance of change

	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
REGION	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	-4	1	-6	1	-17	-2
North East	0	-29	0	-43	-14	-29
North West	-11	6	0	-6	6	-22
Yorks & Humber	0	-21	20	-20	-13	-13
East Mids	11	26	-6	6	-37	6
Eastern	-18	-19	-12	-18	-65	-24
South East & London	-24	-3	-21	-15	-6	9
South West	19	-8	0	0	-8	4
West Mids	24	-24	24	-24	0	-10
Wales	20	40	20	20	-20	0
Northern Ireland	-25	-50	-75	-75	-50	-25

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

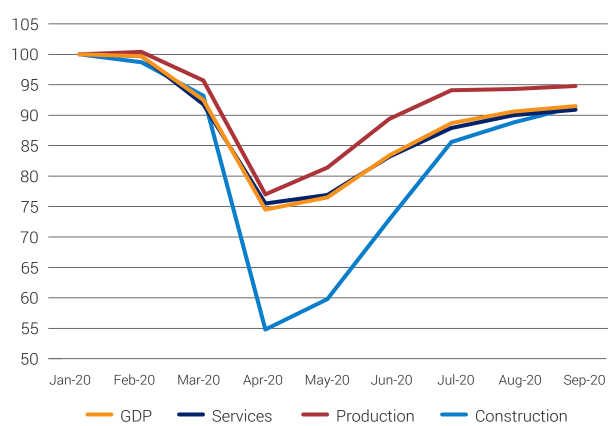
The world recently passed a full year since the announcement of the first official COVID-19 case in China. Since then the global community has been swept up by one of its worst crises in decades. For the time being the UK continues to remain within the peripherals of this storm.

Many analysts initially predicted a quick recovery for major economies given the nature of this crisis to a large extent only delayed consumption and investment rather than prevent it permanently. Recent monthly GDP results produced by the Office of National Statistics (ONS) indicated this to be the case as following a walloping 20.4% decline in activity in Q2 2020 UK GDP bounced back by 15.5% in Q3 2020. This was significantly aided by the Government's well received "Eat out to Help Out" scheme which provided a significant boost to household consumption in August 2020.

There are growing fears this jump in growth will be short-lived as GDP only grew by 1.1% in September 2020 alone. This coupled with a necessary 2nd national lockdown will inevitably create another dip in the time-series for GDP growth resulting in the W-shaped recovery Make UK had forecasted earlier this year.

UK enters recession in Q2

Contribution to real GDP quarter on quarter growth



Source: ONS

Fortunately there have been growing indications that an effective vaccine is on the horizon and may be the only way to return to a normal lifestyle. Yet a level of prudence is necessary for policy-makers who should avoid easing levels of support given there is still much uncertainty on the effectiveness of the vaccine. This, alongside the logistical challenges of mass-producing, storing and delivering the vaccine to all those who need it will require the manufacturing sector to rise to another challenge following ventilators and PPE.

It is expected given manufacturing as a sector is not required to shut during lockdowns that the impact of such restrictions will be felt less severely relative to the previous one. Looking at recent GDP data by sector indicates that manufacturing has been growing slower than the UK average. As it stands, statistics for the Index of Production (IoP) reports manufacturing production is still 7% below its January 2020 index level at 89.45. Relative to other production based industries[1] the manufacturing sector is the most stagnated of the lot.

The indications of a slowdown in recovery as a result of a lack of demand for new work had already been indicated prior to official statistics — for example in the Purchasing Managers Index (PMI) for manufacturing which remains above the 50 mark (the inflection point between expansion and contraction). Although the PMI's have continued to indicate the manufacturing sector is growing, partly thanks to an increase in business from East Asian markets, it is also beginning to creep downwards again adding further evidence the bounce-back would always be temporary and insufficient for the UK's recovery. Nevertheless, all industries suffered a significant decline in activity earlier this year (chart 9) and most will report a similar experience for recovery.

To some extent the Government has recognised that not all sectors were affected equally by the pandemic and did offer tailored support for some. For example, by cutting VAT to 5% for businesses within the Hospitality sector. However, till now subsector specific support for

[1] These include: "Mining & Quarrying", "Electricity, Gas Steam and Air Conditioning" and "Water Supply, Sewerage and Waste Management"

manufacturing has been excluded creating concerns for some valuable parts of the sector, such as aviation and automotive. Particularly as some other large economies (France for example) have unlocked subsector specific support for those industries it deems to be of strategic importance. Although we expect that both aerospace and automotive will benefit from a bounce-back in demand once consumers are able to travel freely again, the difference in approach to protecting the most vulnerable industries between different Governments will result in a shift in the competitive landscape for UK firms post-pandemic.

Interestingly, after months of indications of a sharp rise in job losses the UK Government has yielded to an extension of the Job Retention Scheme (JRS), somewhat in line with the type of extensions witnessed in our EU counterparts. Unfortunately this positive result came after a series of back and forth that almost resulted in the JRS being replaced by an insufficient Job Support Scheme (JSS), followed by a temporary extension of the JRS, which was then followed by a longer term extension of this scheme. All in the space of a few days. This became a highly uncertain operating environment for firms leading many to take up redundancy as a more viable option for business survival. Make UK's monthly Manufacturing Monitor indicated that 49.2% of manufacturers had already made redundancies due to COVID-19, whilst a further 48% are either planning to, or considering, make further redundancies over the next 6 months.

Most will now wonder whether it is too little too late but this does not minimise the achievement of extending such a powerful mechanism to project jobs. According to HMRC statistics, the manufacturing sector had approximately 292,000 workers furloughed in August 2020, down from a peak of 911,000 in April 2020 with an expectation that this will come down much further over time. Especially since the industry is open for business.

The unemployment rate now stands at 4.8%, the highest since late 2016. However, it's likely given the extension of the JRS, the increase in the unemployment rate may decelerate. Forecasts from Oxford Economics indicates the unemployment rate could rise to approximately 6.9% in 2021. Looking forward, a plan that prioritises job creation over preservation may be a more suitable approach if the UK is to achieve a green recovery.

The Prime Minister recently announced a 10-point plan to initiate the UK's "Green" recovery. A noble and necessary target to deal with a challenge that may one day prove much greater than even the current pandemic. The plan will access £12 billion of Government spending to accelerate investments in renewable energy, increasing use of zero emission vehicles and improving access to green finance as well as many others. All the while with a goal to support up to 250,000 green jobs.

As the UK comes closer to finalising an agreement with the EU, in any shape or form, the focus for industry will be about reinstating the enthusiasm manufacturers showed towards investment at the start of 2020. Recent research by Make UK found between 2018 and 2020 there was a 9% increase in firms who have already implemented IDTs (Industrial Digital Technologies) and witnessed an improvement in productivity. Whilst those who are considering implementing new technologies, such as Artificial intelligence (Ai), Augmented/Virtual reality, 3D printing and the Internet of Things (IoT) has increased to 34% of manufacturers (up from 27% in 2018) indicating more businesses are aware of the steps they need to take to improve their productivity[2].

However, the outcome of the UK's trade discussions with the EU is assumed will have a much more prolonged impact than the pandemic on the manufacturing sector. Even in the final few weeks many businesses remain unprepared for the change in trading conditions. For decades the UK has traded with the EU in an open market foregoing the bureaucratic nature of customs which will now increase costs to businesses through both monetary and time means. Moreover, the likely change in regulation means its possible manufacturers who wish to sell their products in both the UK and EU may find themselves needing to produce two types of the same products. Finally, there will be significant changes to the movement of people, posing significant issues for exporting businesses who offer services alongside their goods which make it difficult to send (or receive) engineers across borders. As it stands, although much of these changes are guaranteed regardless of the quality of deal secured it is yet to be fully appreciated by many businesses.

[2] Make UK & Infor (2020), *"Bouncing Back Smarter: Innovation Monitor 2020"*

On the other hand, the UK is also on a mission to set Free Trade Agreements (FTAs) with non-EU countries too. The rest of the world (RoW) makes up approximately half of manufacturing exports and strong deals with countries like the US and China could prove beneficial in the long-term. The incoming President-elect Joe Biden (barring ongoing legal challenges from the current administration) indicates there could be a change in tact between UK-US trade relations but at the moment there is uncertainty to this. Till now the UK has rolled over existing deals with around 50 countries or territories[3]. This is unchanged from our Q3 2020 *Manufacturing Outlook* report. Since then, the UK has successfully secured a trade agreement with Japan, a country which represents only 2% of the UK's trade.

There are significant gaps to close from the perspective of securing trade deals with the EU and RoW, but equally so, it is imperative the process is not rushed as the quality of any deal is as important as the speed at which it is secured.

UK Economic Forecasts

% change except where stated

	2019	2020	2021
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.14	1.13	1.12
Exchange rate ($/£)	1.28	1.28	1.32
Exports	2.8	-11.6	0.4
Imports	3.3	-18.5	6.6
Current account (% GDP)	-4.3	-2.3	-2.9
OUTPUT			
Manufacturing	-1.5	-12.0	2.7
GDP	1.3	-11.3	5.4
COSTS AND PRICES			
Average earnings	3.4	0.5	2.5
Oil price (Brent Oil $/bl)	64.4	41.1	48.0
EMPLOYMENT			
Manufacturing (000s)	2,710	2,644	2,573
Rest of economy (000s)	35,695	35,200	34,309
Unemployment rate (%)	3.8	4.8	6.9

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

	GDP			INFLATION		
	2019	2020	2021	2019	2020	2021
US	2.2	-3.6	3.6	1.8	1.2	1.8
Eurozone	1.3	-7.3	4.3	1.2	0.3	1.2
France	1.5	-9.3	5.7	1.1	0.5	1.1
Germany	0.6	-5.6	3.7	1.5	0.6	1.7
Japan	0.7	-5.6	2.7	0.5	0.0	-0.3
China	6.1	2.0	7.8	2.9	2.9	2.4
India	4.9	-9.4	9.0	3.7	6.4	4.1
World (2015 PPPs)	2.8	-4.2	5.2	3.2	2.8	2.9

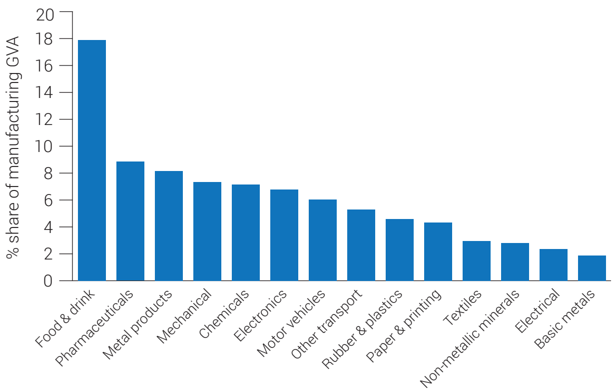
Source: Oxford Economics

3 BBC (20 July 2020), "Brexit: What trade deals has the UK done so far?", Available at: https://www.bbc.co.uk/news/uk-47213842

SECTOR FORECASTS

Q4 2020 Manufacturing 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 in terms of gross value added, saw a marginal increase this quarter in the share contributed to overall manufacturing GVA. Its share of manufacturing GVA is in fact proportionally so large that the next largest subsector contributes half as much to total manufacturing GVA. While consumer demand (primarily referencing grocery) has remained high throughout the pandemic, hospitality and foodservice demand has been hamstrung by the most recent national lockdown. Having seen a somewhat better than expected improvement in foodservice demand in the emergence of the first lockdown, hopes remain high that upon the emergence from the second national lockdown food & drink demand in the hospitality sector will also trend upwards again in the new year. For the time being, output in the subsector for 2020 is forecast to be down by -5%.

ELECTRONICS

The **Electronics** subsector has seen a 2% decrease in terms of the proportion of GVA it contributes to UK manufacturing overall between this quarter and the previous quarter. Despite signs earlier in the year that the subsector was faring well despite the pandemic, reportedly in part due to new demand from businesses seeking to digitalise their process to make them more disruption-proof, output forecasts for the year have been revised downward, standing at -11.6% for 2020. The barriers faced by businesses, particularly in the UK, to invest in capital expenditure throughout the pandemic will have negatively hit big-ticket product demand from the electronics subsector. This extended subdued investment attitude has also hampered other manufacturing subsectors in the UK who are typically on the receiving end of business investment.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector has endured a tumultuous year in 2020. From the infamous troubles and subsequent sale of British Steel, to the restricted demand for downstream finished metal products (e.g. cars), the subsector has seen its fair share of challenges. In any other year, a forecasted total output figure year on year to stand at -15.7% would be standout. However, given the current national circumstance, this figure is not far from the average forecasted output for 2020 across all manufacturing subsectors. While this news is hardly a boon for the basic metals subsector, it does imply that the perils it is facing at the moment are a result of the current low-tide the manufacturing industry currently stands at, as opposed to a subsector specific crisis.

Not dissimilarly to the basic metals subsector, the **Fabricated Metals** subsector has suffered at the hands of suppressed demand throughout the year for downstream finished products. Most notably, the sudden drop in Aerospace manufacturing activity during the pandemic, which the fabricated metals subsector is a key supplier, directly impacted output levels. Total forecasted output in 2020 for the fabricated metals subsector stands at -13.6%, very similar but marginally better than that of the basic metal's outlook.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector is forecast to have the second-worst output decline year on year compared to 2019. With the forecasted change in output standing at -22.9%, the subsector will have endured a historically challenging year. Within UK manufacturing, we can often look to the mechanical equipment subsector be to be proxy for levels of business investment within the UK, (and to some degree abroad as well), as many of its products are bought as a result of capital investment by other businesses. This subsector has seen its output levels suppressed by the subdued investment intentions in the UK industry, a phenomenon that unfortunately predates the arrival of the pandemic and has only been exacerbated by it.

TEXTILES

The **Textiles** subsector continues to fight to stem the bleed of businesses and customers looking abroad, where foreign manufacturers can often offer products at much cheaper prices due to relative labour costs offering foreign competitors a cost advantage. This effect is particularly pronounced in the middle and lower ends of the industry, where volume and variety are preferred over outright quality. The output forecast for 2020 stands at -19.2%, which is worse than the UK manufacturing average of 12%, however, this is a number that has been revised up since the last quarter and there is hope for a quicker recovery than some other subsectors with a double-digit output growth forecast for 2021.

PAPER & PRINTING

In this quarter's renewed sector forecasts, the outlook for the **Paper & Printing** subsector has been downgraded in line with many others, to an overall contraction on output for 2020 at -14.9%. Despite increases in demand for packaged products and general packaging, arising from increases in online shopping during national lockdowns, this has not been enough to offset the loss in demand from other sources. There may be a short-lived demand boom for the sector on the cards at the start of 2021, as after the UK had formally left the EU most products that are for international markets will have to be repackaged with appropriate UK/EU markings, but the size of this effect is unlikely to generate overall positive output growth for the subsector.

ELECTRICAL EQUIPMENT

Despite 2020 output forecasts remaining negative for the **Electrical Equipment** subsector, this particular forecast has been revised up to -8.5% from -15%. This is significantly above the UK manufacturing sector average of a -12% contraction in output for 2020. The forecast upgrade follows better than expected performance in the fourth quarter of the year. Whilst key downstream purchasers in the Aerospace sector continue to offer weak demand, another key purchasing sector, the construction industry, has restarted faster than what was anticipated. Also, the Government's recently announced commitments to continue with both national and local infrastructure projects despite the pandemic will, presuming the projects are realised, stimulate demand for the electrical equipment subsector.

NON-METALLIC MINERALS

The **Non-Metallic Minerals'** key purchaser is the construction industry, which has seen positive growth since June. This has filtered into an uptick in demand for the manufacturing subsector's products, such as bricks, glass and mortar. However, while the construction PMI remains positive, the latest data suggests a significant slowdown in construction activity and this will impact the non-metallic minerals subsector demand in turn. While there has been a recent pickup in demand for the sector over the last quarter, this has not been significant enough to make up for the shortfall in output compared to 2019. Currently, the forecast for output in 2020 remains similar to last quarter at -15.6%. Nonetheless, the outlook for 2021 remains hopeful as more paused construction projects should resume as we progress through the first half of the next year.

PHARMACEUTICALS

The **Pharmaceuticals** subsector continues, as it has done throughout the pandemic, to aggressively buck the negative output trend witnessed in other manufacturing subsectors in the UK. In the fourth and final quarter of the year, our final forecast for 2020 output for the subsector stands at a staggering 14.9% growth in output, which is 26.9 percentage points away from the negative UK manufacturing average of -12% output growth. Quite understandably, the cause of this trend-defeating growth is a result of the coronavirus related interventions that the subsector has to offer in both the foreign and domestic market. This increase in demand is likely to continue well into 2021 as the UK has recently given the green light for the production and sale of BioNTech's COVID-19 vaccines, however, it is currently unknown whether this demand spike will be an extended flash in the pan for the subsector, or, once the pandemic subsides, output levels will return far closer to the UK manufacturing average.

CHEMICALS

The **Chemical's** subsector is now forecast to be the second 'best' performer in terms of output forecasts for 2020 by virtue of its -0.4% output forecast. Not dissimilarly to the pharmaceuticals subsector, the chemicals subsector is involved with many coronavirus related interventions, most transparently in the field of sanitisation products, which has seen unprecedented levels of demand sustained throughout the year. However, this demand cushion is unlikely to remain a staying feature in the subsector's demand composition in the long run, and with the continued question mark surrounding the future regulatory environment when trading with the EU, the underlying fundamentals of the subsector's performance may be less assured than what meets the eye when only considering short-to-medium term output performance.

RUBBER & PLASTICS

The **Plastics** industry has, to the average consumer, seen an increase in demand particularly from the packaging market, resulting from increased sanitisation requirements and to-door delivery preferences. However, as the whole UK manufacturing industry struggles to maintain output levels, so too has the demand for industrial plastics suffered suit, with the consumer plastics demand spike failing to make up for lost output to the industrial sector.

The performance of the **Rubber** subsector in the UK can be closely equated with that of the motor sales market, as in the UK the rubber manufacturing sector is primarily composed of demand from the tyre market. New car registrations continue to be at historical lows, and with the renewed work from home guidance looking set to continue for some time, on-road travel demands will remain suppressed over the coming quarter. Together in both the **Rubber & Plastics** subsector, output is forecast to be -11.9% for 2020.

MOTOR VEHICLES (AUTOMOTIVE)

As has been seen throughout the year, the outlook for the **Motor Vehicles** subsector continues to remain the bleakest out of the entire industry. With a jaw-dropping forecasted output decline of -39% for 2020, 3.25 times the manufacturing average, the subsector is by far the worst affected by the pandemic in terms of its output volume change. As mentioned, new car registrations this year are at historical lows, and as consumers typically look to avoid big-ticket purchases during recessions, it is unlikely we will witness a boom in car buying in the first half of next year too. While the current tentative forecast for output in the subsector for 2021 stands at 19.4%, the loss in real value for the sector will take multiple years to regain despite the industry's best efforts.

OTHER TRANSPORT

The **Other Transport** subsector is comprised of the core industries Defence, Aerospace and Shipping. Businesses within these sectors have had a troubling time in 2020, compounded by the pandemic. Both the loss in demand experienced throughout the year for both international logistics and international travel have directly impacted manufacturers in these subsectors. Many legacy orders have been cancelled as both logistics operators and airlines are forecasting a very weak sales environment for their business moving into 2021. Not only does the data highlight the troubles of the industry, but many household name manufacturers have made public announcements about incoming redundancies and profit warnings. However, providing some degree of relief for the subsector are their typically long order books, so this adds some balance to the extremely negative short term news in the subsector, and contributes to what is, relatively speaking, a moderately negative output forecast in 2020 in comparison to the UK average, at -14.1%. Albeit, this figure has been downgraded by approximately 2 percentage points compared to the 2020 output forecast last quarter.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2019	2020	2021	2019	2020	2021
Basic metals	-5.3	-15.7	1.7	-1.9	-9.9	-2.1
Metal products	-1.6	-13.6	1.7	4.4	-7.0	-0.2
Mechanical	-7.3	-22.9	6.7	2.4	-6.0	-2.1
Electronics	-1.8	-11.6	-0.4	2.3	3.1	-5.5
Electrical	-1.3	-8.5	0.1	1.3	-3.9	-5.5
Motor vehicles	-8.9	-39.0	19.4	0.9	-12.7	-6.3
Other transport	-0.5	-14.1	-0.8	1.4	-7.3	-8.3
Food & drink	1.4	-5.0	2.3	0.4	-0.3	-2.0
Chemicals	-0.7	-0.4	0.3	4.4	6.2	-0.5
Pharmaceuticals	6.9	14.9	-5.4	1.7	2.0	-15.1
Rubber and plastics	0.0	-11.9	4.8	-6.7	7.4	-0.8
Non-metallic minerals	-6.6	-15.6	6.3	4.7	-0.8	-3.5
Paper and printing	0.4	-14.9	-1.8	-0.6	-6.1	-2.2
Textiles	0.0	-19.2	10.1	0.1	4.9	-1.5
Manufacturing	-1.7	-12.0	2.7	0.7	-2.4	-2.8

Source: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

RETHINKING RISK IN THE SUPPLY CHAIN

Following the record breaking lows seen across the manufacturing sector earlier this year, it is heartening to see manufacturers finish 2020 with not only an uptick in output, orders and investment intentions but also business confidence.

COVID-19 has created significant disruption for manufacturers with many describing it as a black swan event. The sheer scale of its impact has indeed been catastrophic; on global economies, entire sectors and our day to day lives.

But from a risk management perspective was it totally 'unconsidered'? For many yes, but others have had such an event on their risk logs for some time. After all, this isn't the first time this has happened. Recently there has been H1N1 (Swine Flu) in 2009, Ebola (2014-16) and Zika (2015-). Many businesses have kept a watchful eye on the risk of a pandemic, and the potential impact on their ability to trade globally.

But why has this particular pandemic had such an impact on our global supply chains? Many would argue it was the way in which countries responded to COVID-19, notably the speed with which highly relevant manufacturing states locked down their operations and trade borders. Previous pandemics failed to stimulate such a comprehensive response. But the sheer immediacy of this shutdown exposed severe vulnerabilities in the production strategies and supply chains of businesses just about everywhere.

Many predict severe consequences of COVID-19, either to repair damaged economies or to address global supply chain weaknesses. Some go so far as to prophesise 'economic nationalism' in response to the need to increase domestic production, protect employment, and eliminate dependencies on sources that are perceived as risky.

WHAT CAN BUSINESSES DO TO ADDRESS THEIR OWN SUPPLY CHAIN VULNERABILITIES?

Companies need to have far greater visibility of their entire supply chain; and this is no mean feat. Global supply chains are in a constant state of flux, often extending well beyond our viewpoint.

You may have a reliable view of your top 20-50 key suppliers, but do you know who their suppliers are; and what about their suppliers? As Thomas Reid wrote, "a chain is no stronger than its weakest link".

Understanding where the risks lie so that your company can protect itself requires a deeper dive beyond your Tier 1 suppliers, and into your Tier 2 and even Tier 3 suppliers. This is laborious and costly but a surprise disruption that brings your business to a standstill can be much more expensive than risk assessing your supply chain accurately.

And it isn't just about one of your supplier's suppliers failing, it is also about their priorities and where you sit within the supply chain. Those companies that have been fortunate enough to continue trading have experienced an eye-opening problem; you may not be the top customer for one of your suppliers and so their limited resources may have been prioritised elsewhere.

We would suggest that companies respond positively to the challenges they are facing, using the pandemic as a catalyst for change and an opportunity to build greater resilience into their supply chain.

And now, as we also near the transition into the new trading arrangements with the EU, any trade resistance could further impact supply chains. Visit our Brexit Hub which highlights practical actions businesses should consider as the end of the transition period approaches: https://www.bdo.co.uk/en-gb/brexit

Tim Foster
Partner, Risk Advisory Services

MAKE uk
The Manufacturers' Organisation

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

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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

BDO IDEAS | PEOPLE | TRUST

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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