In partnership with:

BDO IDEAS | PEOPLE | TRUST

MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2021 QUARTER 1

With support from:

Scottish Engineering and Manufacturing NI

FOREWORD

Stephen Phipson CBE
Chief Executive
Make UK

Richard Austin
Head of Manufacturing
BDO LLP

This time last year the UK entered its first national lockdown to deal with the spread of the novel coronavirus. Up until then the idea that a deadly virus could impact society and the way people do business in the manner we have seen seemed something out of a fictional story. It always seemed a distant possibility, but equally a preposterous one. Even so, many nations prepared for such disasters, according to the John Hopkins University (prior to the pandemic) the UK was ranked as the second best placed nation to deal with such a catastrophe. However, the reality of this challenge was evidently different in practice.

Nevertheless, the world responded to these new challenges. The UK Government responded in unprecedented ways by unlocking fiscal stimulus and support to levels not seen since the aftermath of WWII. Although these policies resulted in a spike in the national debt, the cost of doing nothing could have been much greater. And so we got the Job Retention Scheme, which has been an invaluable tool to place the UK economy in stasis until the virus was under control. We opened up the credit markets with access to government backed securities to support many businesses in the short-run. We delayed tax payments and created schemes to incentivise hiring our youths. A lot was done to ensure that the UK would be in the best possible position to return to “normality”. Going forward, a lot more will be needed to grow the economy out of this predicament.

Industry responded too. Particularly manufacturing, which rallied to a call to arms to support the National Health Service (NHS). A stampede of manufacturers redirected resources to provide much needed PPE, sanitation products, medical devices and even food to keep the nation going. Manufacturing is traditionally a sticky sector that makes it difficult to shift production lines to new products, yet advancements in technology have allowed many of us to realise the sector is more malleable than we previously thought.

Fast forward one year on and there are now successful vaccines on the market. It is the first time vaccines have been produced at pace and highlights how powerful human ingenuity can be in times of crisis. With the UK’s vaccine programme starting to bear fruit, the UK manufacturing sector has responded with an improvement in business and economic confidence. As the UK’s leading barometer of manufacturing economic activity, Make UK and BDO’s latest *Manufacturing Outlook* has indicated that we are slowly arriving at the light at the end of this long tunnel. Output levels are on the rise for many manufacturing subsectors across the nation as businesses come to grips with a post-Brexit, and soon to be post-Brexit-COVID-19, world.

However, the export performance remains a concern for manufacturers, particularly SMEs, who face the consequences of exiting a single market. In the past, shipping goods to France or Germany was as easy as manufacturers in the North East transporting goods to the south of England. Now businesses are faced with a plethora of red tape and bureaucracy which will disproportionately impact the smaller companies that lack expertise than the larger firms that are more able to absorb these costs. Fortunately this quarter has reported an end to the continued decline of domestic orders, which lasted almost two years. This is primarily a reflection of the economy re-opening which has positively affected order books. Although it is too early to tell, it may also indicate a substitution of supply-chains from overseas inputs to more domestic sources, where these are available.

The Chancellor has announced an extension to the Job Retention Scheme in his recent budget and this will go a long way to supporting struggling businesses until the economy reopens completely. However, the survey indicates job losses remain high, albeit the rate of loss is slowing. Investment intentions have improved this quarter, though they remain negative on balance since Q2 last year. Investment is the lifeblood of the manufacturing sector, and the recently announced super deduction scheme, which will allow businesses to reduce their tax bill by up to 25p per £1 invested may turbocharge investment intentions in the short-run. What is not clear about the impact of this incentive is whether it will increase new investments, or only bring forward investments that were already planned.

HEADLINES

Make UK's Q1 2021 *Manufacturing Outlook* report, in partnership with BDO, updates on the tumultuous year that was 2020 which saw manufacturers deal with both the COVID-19 pandemic and leaving the EU.

Ever since our quarterly survey reported a record breaking fall in the output balance in Q2 2020, the sector has been gradually rebuilding, restarting and reopening. The last two quarters of this survey indicated the rate of decline for output and orders was slowing, even improving for some businesses.

The latest figures for many of our metrics indicate a much more positive start to the year for the sector as a whole, although there are still concerns around exports, employment and investment plans over the next 12 months. Albeit, a word of caution should be adhered to as due to the declines of last year the sector is starting from a lower base. Hence, much of the growth indicated in the latest survey represents a catch-up to pre-pandemic levels of activity.

As the UK accelerates its vaccination programme, and plans a cautious roadmap out of the 3rd national lockdown, the latest results indicate the manufacturing sector has been instilled with the much needed confidence to do business. The output balance has reported a positive balance of 9% for Q1 2021, the highest balance reported since Q4 2019. However, the figure is still low by historical standards and indicates that only a small proportion of the sector is performing better.

UK orders has now turned positive for the first time since Q2 2019 ending almost two years of negative balances, reporting at 6%. However, export orders have declined further on balance as manufacturers face new trade barriers between the UK and EU. Nevertheless, manufacturers remain enthusiastic about business activity going forward and forecast orders to improve across the board next quarter. Furthermore, prices have continued to increase as the cost of inputs and intermediate goods are absorbed into the value of goods produced. However, profit margins remain weak this quarter, although domestic margins have improved slightly on Q4 2020.

The short extension of the Job Retention Scheme (JRS) will have a positive, albeit minimal, impact on the manufacturing sector's ability to return to full capacity. A long-lasting use of the scheme is unlikely as Government will want to avoid an increase in dependency on a fiscally unsustainable policy. Nevertheless, alternative Make UK surveys already indicate redundancies have taken place, now the focus on growth and re-hiring should take precedent. The investment intentions balance remains troublingly negative, although improved on the last few quarters. Though the figure is still concerning, the upward trend in the data suggests it would not be out of line to expect positive intentions in the near future.

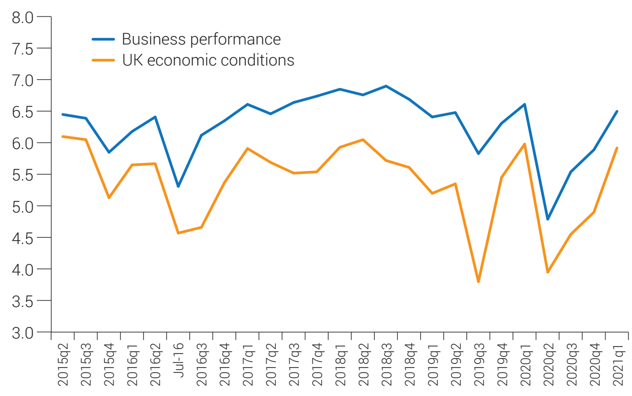
INDICATOR	BALANCE	CHANGE	
Confidence	6.5	↑	Confidence increased for the 3rd quarter in a row
Output	9%	↑	Output balance positive for the first time since Q1 2020
UK orders	6%	↑	UK orders balance positive for the first time since Q2 2019
Export orders	-8%	↓	Export orders falls as the impact of Brexit slows trade
Employment	-6%	↑	An improved employment balance highlights job losses are slowing
Investment	-6%	↑	Investment intentions improves but remains negative on balance

Source: Make UK Manufacturing Outlook Survey

Both business and economic confidence are positive (above 5) this quarter as recent developments in vaccines have raised the possibility of returning to normal life.

Confidence continues to trend up

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

Make UK's last *Manufacturing Outlook* survey, which pre-dates the 3rd national lockdown, indicated that output amongst a larger share of manufactures was beginning to trend upward. Although, a balance of 5% of businesses still reported a fall in output last quarter to top off an abysmal year for a sector that saw record breaking falls in output and orders. However, the industry has continued to do business in uncertain times and despite the trade deal with the EU being less than ideal, new work is gradually returning. In addition, the improving output may also be a consequence of stockpiles having been depleted for many firms, therefore resulting in new production.

This quarter's survey covers the period in which a 3rd national lockdown was implemented, whilst the vaccination programme was also accelerating at speed. In that time many businesses were also grappling with the new processes and costs associated with leaving the EU. However, the survey pre-dates the Chancellor's budget announcements and therefore it is not clear how announcements will impact forecasts for the next quarter.

As such, the latest *Manufacturing Outlook* survey for Q1 2021 reported an output balance of 9%, up from -5% last quarter.

The good news this quarter is that the improvement in the output balance far exceeded what businesses predicted last quarter (-3%), a result of the boost to confidence provided to business owners thanks to the speedy vaccine rollout.

UK manufactures now expect this trend to continue into the next quarter too.

The latest survey reports mixed results for individual subsectors. However, despite the positive performance, some subsectors continue to feel the weight of subdued activity.

Basic Metals reported a negative balance of 27% of firms recording a decrease in output over the last three months, significantly worse than last quarter, which saw a balance of 8% reporting an increase in output. This subsector in particular relies on demand from downstream sectors as well as international trade. In addition, the continued weak performance of the Metal Products subsector, which reported a -6% output balance, is negatively affecting Basic Metal performance through supply-chains.

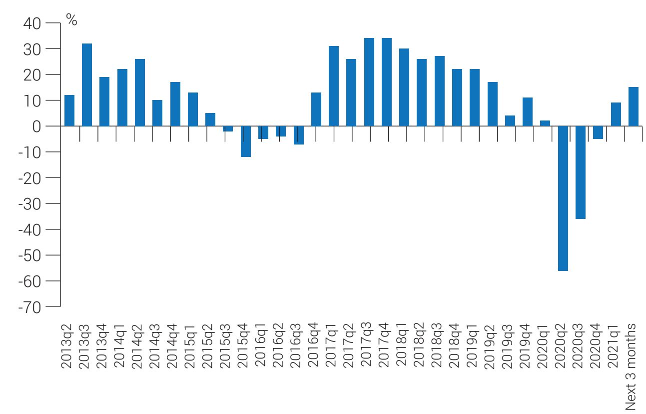
The Electronics and Electrical Equipment subsectors reported positive balances again, with the former substantially outperforming the UK average output balance indicating demand for technology amongst businesses and households remains robust. Interestingly, Mechanical Equipment has also improved to a weakly positive 3% balance of output, this subsector can be a proxy for investment in capital goods.

Rubber and Plastics reported an output balance of 0% indicating that approximately an equal amount of firms either did worse or better than they did last quarter.

PAST THREE MONTHS	↑	9%	NEXT THREE MONTHS	↑	15%

Output turns positive for the first time since Q1 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	-27%	9%
Metal Products	-6%	9%
Mechanical	3%	22%
Electronics	55%	17%
Electrical	6%	-13%
Rubber & Plastics	0%	0%
TURNOVER		
£0-9m	-11%	7%
£10-24m	10%	19%
£25m and over	36%	35%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The latest results indicate output and orders continue to move together, as the total order balance has improved to its best level since Q1 2019. However, as an isolated balance of change in one singular point of time the figures do not necessarily indicate impressive growth by any means.

The survey reports that a balance of 9% of manufacturers have reported an increase in total orders over the last three months, this is up from a negative 3% balance last quarter.

The figures highlight the process of reopening and restarts for manufacturers across the nation which is less subject to lockdown restrictions. The sector itself is complex in nature by way of supply-chains as demand returning from a small number of (large) firms can have propagative indirect effects that result in orders and output improving through these networks. Although, the latest survey does not indicate by which magnitude orders has improved, it is promisingly moving in the right direction.

Fortunately, expectations made by manufacturers last quarter indicated orders performance could get worse and the latest survey, at least for the domestic market, suggest that is not the case. Now manufacturers expect for Q2 2021 the order balances across the board should improve but these will be dependent on the success of the vaccination programme, as well as the possibility of future lockdowns.

One particular issue that will dominate the rest of the year, besides the pandemic, is the impact of leaving the EU on trade. Recent Make UK research has already indicated manufacturers have faced incredible disruptions as a result of recent changes. For example, one in three manufacturers had reported they had no experience of completing certificates of origin forms. Leaving the EU is a disruptive process, but the majority of the sector will survive in the long-run. Yet, it is not guaranteed that the sector will be in a better place by trading more with the rest of the world.

UK ORDERS

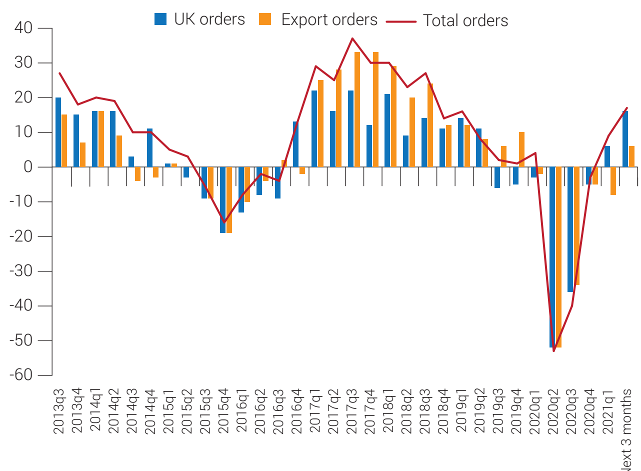
UK orders balance improved to 6% this quarter, the result indicates on balance a larger share of manufacturers saw an increase in domestic orders relative to those that saw a fall.

It is surprising to report a positive UK orders balance as domestic orders have been negative since Q3 2019. It is not obvious what resulted in the sudden surge in domestic sales but the possibilities include an increase in UK confidence resulting in greater spending by manufacturing customers. In addition to the confidence boost, the increased difficulties in sourcing components from the EU has resulted in some substitution between foreign and domestic inputs. In order to avoid the increased cost of moving goods across borders it is relatively cheaper for some to source alternative goods locally.

UK ORDERS	PAST THREE MONTHS	↑	6%	NEXT THREE MONTHS	↑	16%
EXPORT ORDERS	PAST THREE MONTHS	↓	-8%	NEXT THREE MONTHS	↑	6%
TOTAL ORDERS	PAST THREE MONTHS	↑	9%	NEXT THREE MONTHS	↑	17%

Export orders continue to worsen as the impact of leaving the EU slows trade

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

However, as always the change in the UK order balance is not distributed equally between different subsectors.

As was the case for the output performance, Basic Metals reported a worse -45% balance as domestic demand for key metals (aluminium, zinc, copper) remains weak. However, the subsector is positive about the next quarter. This is because UK orders in Metal Products improved and this should in theory result in new work for Basic Metal firms via supply-chains.

In summary, both Electronics and Mechanical Equipment reported positive output balances, with the former again outperforming the UK average. However, Electrical Equipment and Rubber & Plastics reported overall declines in domestic activity. Both subsectors outperformed last quarter and the fall in orders this quarter is likely more associated with seasonal cyclicality.

EXPORT ORDERS

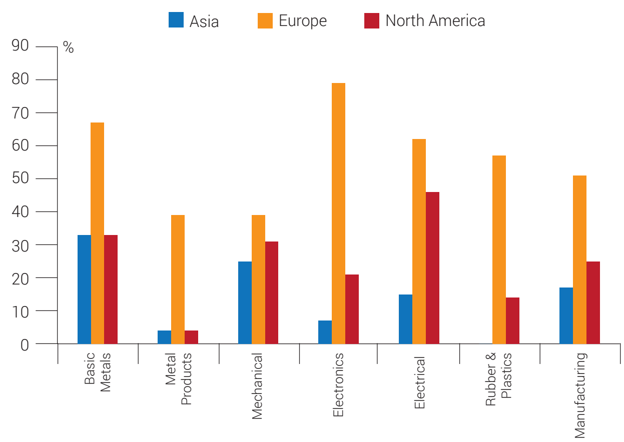
Export orders reported a balance of -8%, a small decline from last quarter's -5%.

Although other *Manufacturing Outlook* metrics indicate an improving sector, the exports narrative remains a concern as it is less part of an uncontrollable COVID-19 story, and more so related to the impact of leaving the EU. Across key intermediate subsectors, all but Electronics reported a fall on balance in export orders over the last three months, indicating demand from international downstream subsectors must also be low. For the time being, it is not clear whether the poor performance of exports is down to the early adjustment period of the EU-UK Trade Cooperation Agreement (TCA).

Most manufacturers reported positive demand conditions in the EU despite leaving the trading bloc. In many cases, manufacturers do not have an alternative source of inputs nor are they easily able to substitute sales to non-EU customers quickly if relationships do not already exist. Nevertheless, a quarter of firms reported positive demand conditions from North America whilst only 17% reported the same for Asia.

Demand conditions improve in North America and Asia

% 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	-45%	9%	-33%	0%	-45%	9%
Metal Products	3%	3%	-32%	-7%	11%	0%
Mechanical	8%	19%	-1%	14%	9%	25%
Electronics	13%	22%	19%	24%	30%	22%
Electrical	-6%	20%	-33%	-27%	-19%	6%
Rubber & Plastics	-29%	-20%	-43%	-17%	0%	-29%
TURNOVER						
£0-9m	-13%	11%	-21%	-19%	-14%	7%
£10-24m	12%	24%	6%	21%	23%	28%
£25m and over	32%	25%	8%	18%	37%	35%

Source: Make UK Manufacturing Outlook Survey

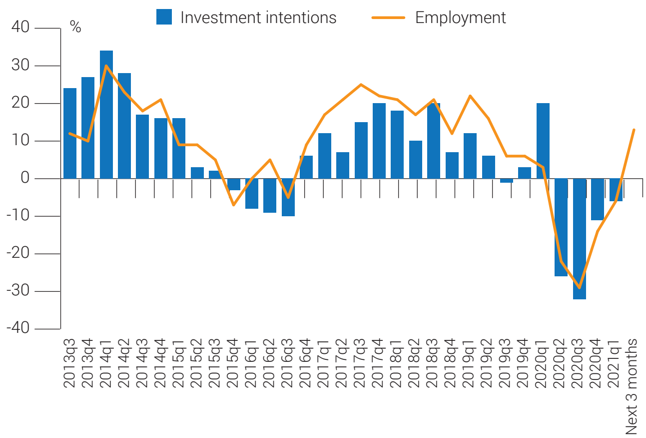
EMPLOYMENT & INVESTMENT

This quarter's research shows that, while the balance figure for employment is still marginally negative, our metric for employment is trending upward in an encouraging fashion. To compound the positive story emerging here, manufacturers' expectations for employment in the next quarter are reported to be positive, which marks the first time they have shown positivity since our first quarter 2020 research a year ago.

Despite this positivity, there still looms the question: How severe of an impact will the wind up of the Job Retention Scheme (JRS) have on employment intentions? As expected, the Chancellor's recent announcement of another extension to the JRS was announced in the March budget, along with a plan to taper off the scheme, likely further cushioning any negative drivers in the employment figures. Nevertheless, as we move into the second quarter of the year, its days are numbered as the Government is keen to ensure that the labour market does not become institutionalised to what is fiscally unsustainable support from the taxpayer in the long term. There is little doubt that the scheme's wind up will harm employers' propensity to employ, yet with the significant positivity reported for these intentions in the immediate future, there is certainly an opportunity for a scenario in which the scheme winds up and employment intentions in the manufacturing sector remain positive.

Whilst investment and employment remain negative, expect positivity next quarter

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑	-6%	NEXT THREE MONTHS	↑	13%
INVESTMENT	NEXT TWELVE MONTHS	↑	-6%			

In the sectoral and turnover breakdowns of these employment intentions it is apparent that there has been a significant degree of variability depending on the type of industry the employer is engaged in and the firm's size, with some subsectors and firm sizes reporting positive balance figures for this first quarter. Nonetheless, what these breakdowns are unanimous in reporting is the significant improvement in their respective employment intentions by the second quarter of the year, serving as a strong cross-industry signal that a demand for fresh labour will be industry wide.

In a not-dissimilar fashion to the trend exhibited within the employment data, investment intentions remain marginally negative in this first quarter, but are significantly less negative than the preceding three quarters. While the investment data suggests that these intentions are still quite a way off the spike in the positivity that we saw in the first quarter of 2020, the trend away from severe negativity that we have observed over the past year is a welcome one. This news will be particularly welcomed by those sectors within the UK economy, manufacturing and elsewhere, which are the typical recipients of capital-expenditure, such as those in the mechanical equipment subsector for example. While the upward rate of change quarter-to-quarter for investment intentions has slowed, it is a sensible expectation that a positive figure for investment will be reported next quarter. Now with the Chancellor's announcement of the 'Super-deduction' investment incentive scheme (130% capital allowance), we very much so expect to see our investment metric spike aggressively in the next few quarters as eligible businesses rush to take advantage of the scheme. However, due to the short two-year window of opportunity this scheme offers, it does not add too much confidence to our expectations of improved investment in UK manufacturing in the long term.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	-64%	-18%	-36%
Metal Products	-14%	6%	-14%
Mechanical	-4%	19%	-13%
Electronics	9%	26%	32%
Electrical	-19%	6%	-25%
Rubber & Plastics	0%	0%	-14%
TURNOVER			
£0-9m	-15%	10%	-5%
£10-24m	12%	22%	0%
£25m and over	-3%	24%	7%

Source: Make UK Manufacturing Outlook Survey

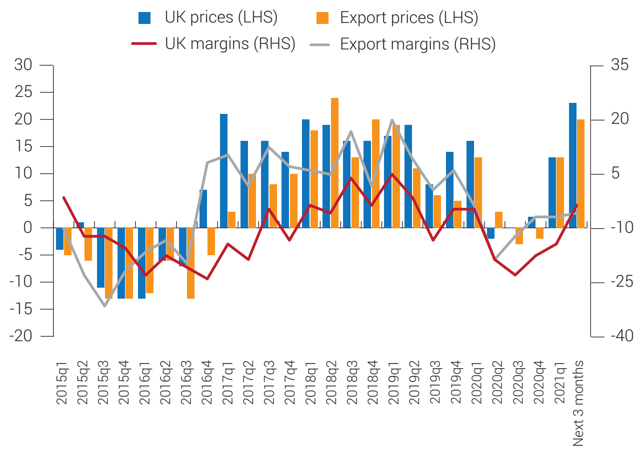
PRICES & MARGINS

The impact of leaving the EU on UK manufacturers is having disruptive effects on the cost of exporting as well as sourcing inputs from the bloc. The combined impact of new forms, paperwork, taxes and increasing lead times is resulting in a more widespread rise in prices, both in the domestic and international markets. The latest *Manufacturing Outlook* survey reported a balance of 13% of manufacturers increasing UK and Export selling prices over the last three months.

The higher input costs are partially being priced into new contracts between suppliers, but the total incidence (or burden) of increased bureaucracy and taxation is likely being shared between the manufacturer and its customer. This is reflected in the latest figures for margins, which indicates some improvement on Q4 2020 due to improving levels of new work but remains negative on balance. The data reports a negative balance of 16% of manufacturers reported a fall in UK margins, better than last quarter's 19% that reported the same. In contrast, a negative balance of 9% of manufacturers reported a fall in Export margins (no change on last quarter). The impact of Brexit is evident in the level of change since last quarter, which suggests international margins are improving at a slower rate than UK margins.

Selling prices increase but margins remain subdued

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑	13%	NEXT THREE MONTHS	↑	23%
EXPORT PRICES	PAST THREE MONTHS	↑	13%	NEXT THREE MONTHS	↑	20%
UK MARGINS	PAST THREE MONTHS	↑	-16%	NEXT THREE MONTHS	↑	-6%
EXPORT MARGINS	PAST THREE MONTHS	↔	-9%	NEXT THREE MONTHS	↑	-8%

Further evidence of the impact on leaving the EU on prices is also seen subsector wise. Almost all key intermediate subsectors, excluding Rubber & Plastics, reported rising export selling prices over the last three months as the cost of trade weighs on business.

Over the next three months, manufacturers' expect prices and margins to improve. However, export margins are expected to improve by less than UK margins.

The European Brent Price of oil averaged approximately $49 per barrel between November 2020 and January 2021, with the most recent prices varying around the $60 per barrel range. Evidently, oil prices are slowly returning to pre-pandemic levels as positive news stories around vaccinations and successful lockdowns raise the possibility of demand for crude products increasing.

The Sterling-Euro exchange rate averaged around €1.1 in Q4 2020 according to the ONS, indicating little or no change on Q3 2020. However, the confirmation of a deal with the EU did result in a slight increase in demand for GBP that has continued to trend upwards gradually since.

Export prices increasing for intermediate goods

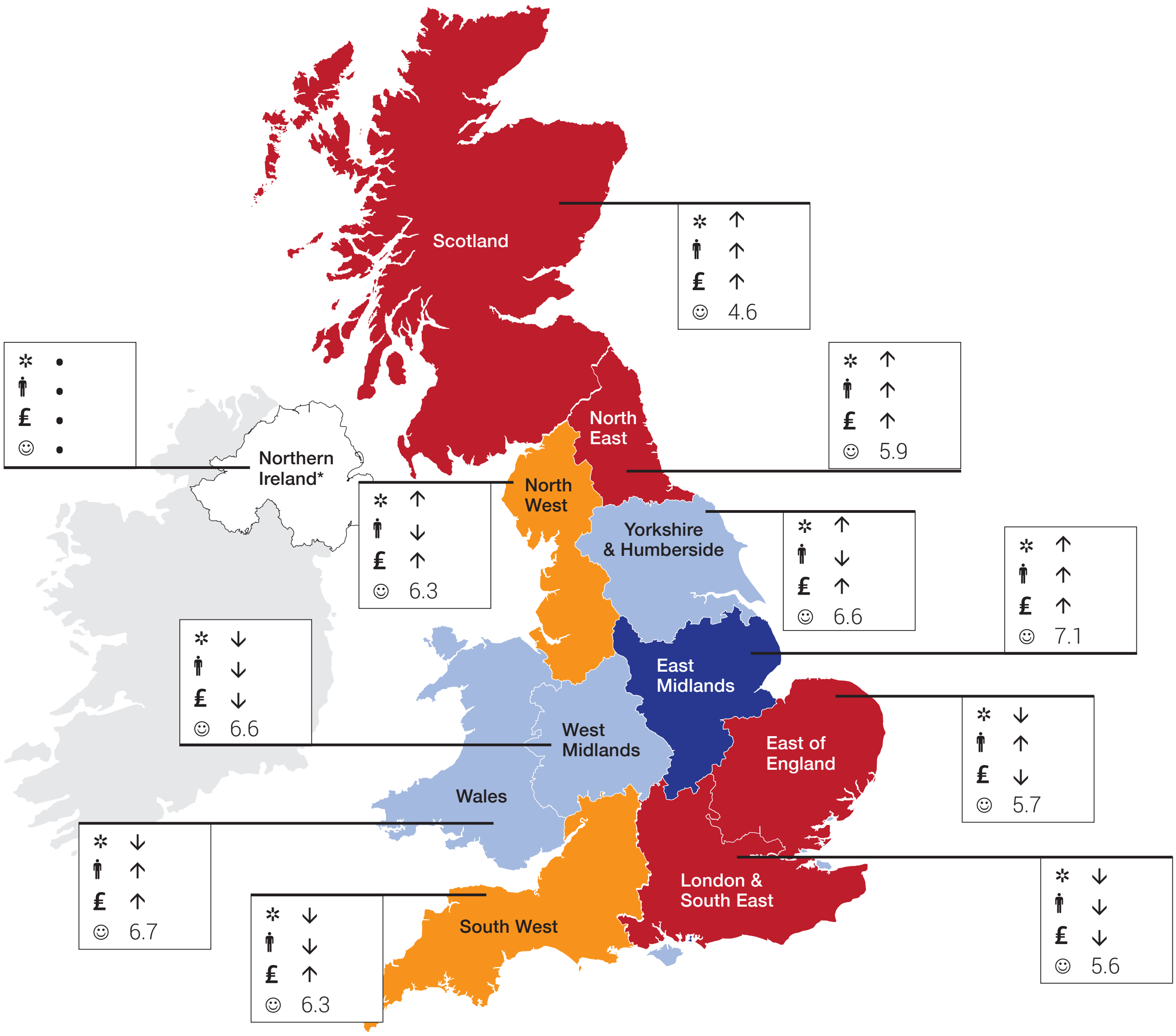
% balance of change in export prices in the past three months

Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

Business confidence is perhaps the most volatile metric in response to socio-political events. In this first quarter of 2021, not only do we have the expectation that the immediate struggle with the coronavirus will likely be coming to a close, but it also marks the first quarter in which the UK has left the European Union in earnest.

All regions and nations have reported improvements in their business confidence in this first quarter, with the exceptions of Scotland, the North East and the South East & London reporting slight declines. Despite this, all are reporting positive business confidence (above the '5' inflexion point), excluding Scotland. However, the confidence measurement



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
OUTPUT
EMPLOYMENT
£ INVESTMENT
BUSINESS CONFIDENCE
● INSUFFICIENT NI DATA FOR CALCULATION IN THIS INSTANCE

HIGH CONFIDENCE

LOW CONFIDENCE

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

Source: Make UK Manufacturing Outlook Survey

in Scotland follows a slightly different survey elicitation method, which means Scottish confidence values should be compared only with other Scottish confidence values, and as such are not interoperable with the rest of the UK. With this in mind, Scottish confidence has only dropped extremely marginally (-0.05) compared to our previous edition of *Manufacturing Outlook* at the end of 2020.

The largest positive shift in confidence this quarter came from the Yorkshire & the Humber and the East Midlands, reporting improvements on last quarter by 1.2 and 1.1 points respectively. The largest decline in confidence compared to last quarter came from the South East & London, with a change of -0.7 points.

The headline UK average figure for business confidence is 6.5, a significant improvement from the already positive confidence figure reported last quarter at 5.89. While the overall increase in business confidence is in keeping the increases we've seen in the majority of our *Manufacturing Outlook* metrics (Orders, Output, etc.), it still comes somewhat of a surprise when stood in contrast to the UK's ongoing struggle with COVID-19, and critically, the UK's very recent exit from the European Union.

At the end of 2020, it was not expected that optimism would raise this fast within the period of one quarter given the aforementioned events, suggesting that the manufacturing sector in the UK is likely to have an even better start to 2021 than was previously anticipated.

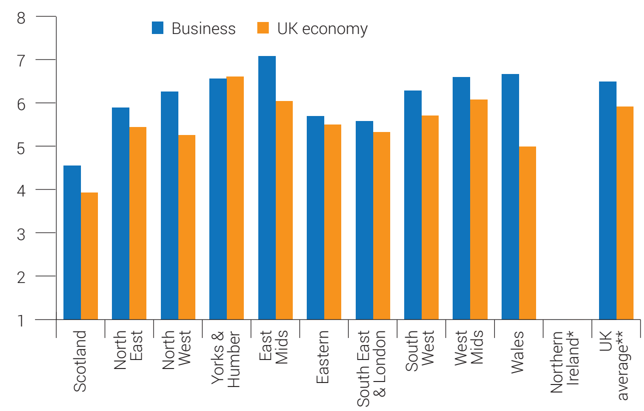
UK ECONOMY CONFIDENCE

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 1 whole point compared to last quarter, standing at 5.92. As we predicted last quarter, UK economy confidence has finally turned positive again (last quarter 4.9), following a year of endured negativity from UK manufacturers about the UK's economic prospects.

The confidence scenario we currently report, with both positive UK business confidence and UK economy confidence, has not been seen since before the pandemic.

Firm-level confidence experiences positive spike, and UK economy confidence positive for the first time since pre-pandemic

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



* Insufficient NI data for calculation in this instance

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

Source: Make UK Manufacturing Outlook Survey.

Regional summary

% balance of change

	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
REGION	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	1	9	-8	14	-9	15
North East	22	25	22	-11	-11	0
North West	-5	0	18	-17	-26	9
Yorks & Humber	11	33	6	47	-17	6
East Mids	36	33	46	29	24	36
Eastern	-20	-22	-50	0	-20	-10
South East & London	-46	23	-17	25	-23	-8
South West	-12	6	-18	-13	-25	0
West Mids	-4	42	8	44	-28	13
Wales	0	-33	33	0	0	0
Northern Ireland*	–	–	–	–	–	–

* Insufficient NI data for calculation in this instance

Source: Make UK Manufacturing Outlook Survey

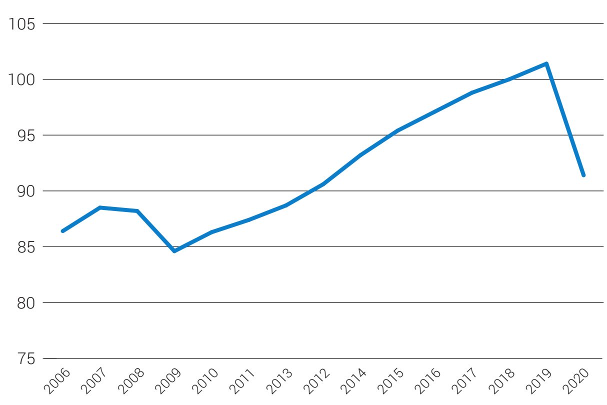
ECONOMIC ENVIRONMENT

This month marks the anniversary of when the UK first locked down the nation. It was not the first time the UK had faced the threat of a viral infection (recall swine flu) but never had the flow of society been forced to stop in such a manner. The health impact has been devastating globally, and there is a gaping hole in the UK economy now. However, when the conditions are right human ingenuity can solve almost any problem and the development of a series of vaccines in record time raises hope for many businesses that are looking to move forward.

Nevertheless, the UK is now in the latter stages of its 3rd national lockdown and GDP growth has remained low in that time. Recent monthly GDP results produced by the Office of National Statistics (ONS) reported 1.2% growth for December, averaging an overall 1% growth for Q4 2020. Overall, the economy declined by a record breaking 9.9% in 2020 (Chart 9). The stop-start style of economic activity makes historical comparisons difficult but the overall decline in 2020 has largely been consistent with many analyst's forecasts, including Make UK's. However, if there were no further lockdowns going forward we can expect a short-term boost to economic activity as pent-up demand is released, particularly for subsectors like aerospace as well as small businesses with services that lack an online presence (salons for instance).

GDP falls by a record breaking 9.9% in 2020

Annual Index (2018 = 100), 2006 - 2020



Source: ONS

It is unlikely we will see more instances of astronomical changes in month-on-month GDP growth, such as what was reported last year when output declined by 20.4% in April alone. However, many sectors in the UK economy, like hospitality, could benefit from another Eat Out to Help Out scheme (or something to that effect) especially if the likelihood of further lockdowns was close to zero. Still, many manufacturers believe there is quite some time left before we return to normal trading conditions. Make UK's recent Manufacturing Monitor survey indicates approximately half of manufacturers believe they will return to their pre-COVID operating levels by the end of the year. However, during this time businesses are also tackling the red tape of trading with their most important economic partner, the European Union (EU). For most it is a matter of adjusting to new processes, however the additional costs will eventually be priced into contracts which will negatively impact the manufacturing sector's competitiveness on the global stage.

Not all parts of the economy outperformed Q4 expectations and this is highlighted by the latest Index of Production (IoP) figures. Despite the UK growing by 1.3% at the end of last year, this was dominated mainly by services that have been able to continue doing business from home. Whereas the production index for the whole production industry stands at 93.98[1] (where 2018 = 100). Within this, the manufacturing sector only expanded by 0.3% in December 2020 indicating the sector is just about holding its head above water as it grapples with COVID-19 and Brexit simultaneously.

Recent Purchasing Managers Index (PMI) figures have been indicating that the manufacturing sector is projecting upwards as orders start to return. Yet many manufacturers have been highlighting that supplier-lead times have been worsening between UK-EU borders and the increase in red tape and bureaucracy have been resulting in sharp rises in input costs. The PMI's do not reflect real activity as each data point indicates whether

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

the sector has improved or worsened in hindsight of the previous month, however, the results are optimistic and do suggest that manufacturers are on the right track for recovery.

One of the biggest concerns of the pandemic is the impact on employment rates, which in turn affects the labour force's skills and negatively impacts the welfare of individuals. Indeed, income poverty can result in a vicious cycle that lowers the overall quality of life for entire populations – these effects tend to be more pronounced in locations with a larger concentration of unemployed workers. However, the Government's Job Retention Scheme (JRS) has been a saving grace for many workers, as well as for businesses desperate to retain their best and brightest in hard times. The fear remains amongst many that once the JRS expires for good the unemployment rate will skyrocket unless the economy is able to run freely again. The Office of Budget Responsibility (OBR) estimates unemployment will peak at 6.5% in 2021. This forecast was estimated in anticipation of the Chancellor's spring budget 2021, and it is not clear whether they are expected to worsen or be delayed further into the year or both.

In order to ensure that Government support aligns with the expected timeline of the pandemic the JRS has been extended till September 2021. However, due to the unpredictable nature of infections and mutations of the virus it is challenging to plan effectively. Yet, as many of the UK's EU counterparts have done – it is better to be safe than sorry. At this point mainly sectors that are unable to do business are utilising the furlough scheme the most. Make UK research has shown that 55% of manufacturers are still using the scheme, and for those that are the majority (37.8%) is furloughing less than 10% of their workforce.

Looking forward, a plan that prioritises job creation should precede saving jobs. A common feature of many economic downturns is a sharp rise in new start-up businesses – for many these are simply a means to an end to putting food on the table. However, each new idea has the potential to grow and contribute substantially to output and employment. The Government has already laid out its 10-point plan to make the UK more "Green" but it must also develop a long term domestic strategy that creates the conditions for businesses to thrive and scale. These businesses do not need a Job Retention Scheme, instead they need a Job Creation Scheme that will allow them to harness the skills required to grow their business. As a result, the economic benefit of a scheme that creates jobs could help solve the skills gap which has been an issue in manufacturing long before recent events.

The climate crisis is possibly a larger threat to humanity than even the pandemic or leaving a trade union. Achieving net zero however is a slower game and the 10-point plan will go some ways to reaching this by creating over 250,000 green jobs by 2030. In addition, the net-zero target will also provide many businesses the opportunity to contribute as Government support is directed to those with clean ideas. The banning of petrol and vehicle sales by 2030 will incentivise many automakers to accelerate electric vehicle production, as well as research & development of alternative fuels (such as hydrogen fuel). In terms of the jobs of tomorrow, even a job creation scheme could be designed for the purpose to support only those start-ups with innovative green inventions.

How the UK continues to proceed with its relationship with the EU, now that a Trade Cooperation Agreement (TCA) has been signed between both parties, will determine the UK manufacturing sectors performance. This is because the importance of the EU to manufacturers has not changed despite the new systems in place. Following the foundations laid by the gravity model of trade the EU is still the best sources of inputs for business as its geographical position minimises expected lead times for most good and services. Therefore, in some cases the opportunity cost of switching to a non-EU based source of inputs may still be greater than the added cost of importing directly from the EU. The same could also be said for exports. Nevertheless, as an independent nation there will be opportunities for many subsectors to benefit from these new arrangements assuming the UK's relationships with non-EU nations strengthens.

Alongside navigating the new partnership with the EU, the UK will also need to monitor closely the activities of the rest of the world, particularly developed nations. A successful vaccination program can solve the domestic challenges of the pandemic but inadequate attempts to eliminate COVID-19 elsewhere can expose the UK to future spikes in infections. Fortunately, many countries are accelerating vaccinations and some have also pledged to donate excess supplies to developing nations that are most at risk.

According to the Organisation for Economic Cooperation and Development (OECD) statistics, OECD nations overall reported a 0.7% growth in GDP in Q4 2020, whilst the Euro area reported a 0.6% fall in GDP in Q4 2020. In contrast, the East Asian markets have been performing well as Japan reported a 3% growth in GDP in the final quarter of last year.

UK Economic Forecasts

% change except where stated

	2020	2021	2022
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.11	1.12
Exchange rate ($/£)	1.28	1.37	1.39
Exports	-13.2	2.2	4.7
Imports	-17.8	6.5	6.5
Current account (% GDP)	-3.4	-3.1	-3.2
OUTPUT			
Manufacturing	-9.9	3.9	3.0
GDP	-9.9	5.5	6.0
COSTS AND PRICES			
Average earnings	1.6	3.9	2.7
Oil price (Brent Oil $/bl)	41.8	55.5	56.6
EMPLOYMENT			
Manufacturing (000s)	2,618	2,547	2,571
Rest of economy (000s)	35,029	34,335	35,220
Unemployment rate (%)	4.5	5.9	5.1

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

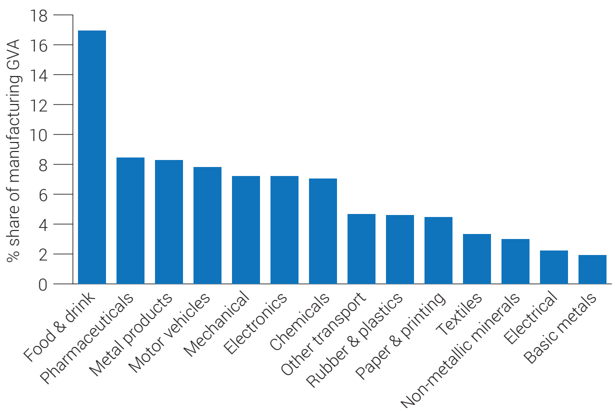
	GDP			INFLATION		
	2020	2021	2022	2020	2021	2022
US	-3.5	5.9	2.7	1.3	2.6	2.2
Eurozone	-6.8	4.1	4.8	0.3	1.4	1.4
France	-8.3	5.0	4.8	0.5	1.2	1.5
Germany	-5.3	3.6	4.7	0.5	1.8	1.5
Japan	-5.0	2.6	2.4	0.0	-0.4	0.3
China	2.3	8.9	5.4	2.5	1.7	2.9
India	-7.1	10.2	6.1	6.6	4.5	4.6
World (2015 PPPs)	-3.6	5.8	4.5	2.8	3.2	2.9

Source: Oxford Economics

SECTOR FORECASTS

Q1 2021 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: ONS

FOOD & DRINK

For the **Food & Drink** subsector, the largest manufacturing subsector in the UK in terms of gross value added (GVA), saw approximately a one percent change in its share contributed to overall manufacturing GVA output compared to last quarter. Despite this, the subsector remains the most significant contributor to overall manufacturing output in the UK by quite some margin. Following a somewhat tempered decline in its output in 2020, cushioned by a significant spike in demand for domestic foodstuffs during the pandemic, the outlook for 2021 is positive, with a growth of 1.7% in output forecast. This is notably less positive than many other subsectors, but this is largely a result of the subsector not having suffered as deep of a loss in output in 2020 when compared to others. There is no significant change expected in employment for the subsector in 2021, yet this can be construed somewhat positively as the majority of subsectors are expected to see continued declines in their respective employment figures.

ELECTRONICS

Following a two percentage point decrease in its overall contribution to manufacturing GVA last quarter, the **Electronics** subsector has now seen a modest increase, of approximately 0.3%, compared to the figures we reported at the end of 2020. Output decline in 2020 was slightly better than the manufacturing average at -7.3%, and now for 2021 we forecast growth just slightly under the manufacturing average at 3.5%. Bucking the trend in 2020, the subsector actually saw its employment grow, albeit only by 2.7%. Nevertheless, this occurred whilst the manufacturing average employment change in 2020 was -2.8%. Employment is still expected to fall in 2021, but at a rate about half as severe of that as the manufacturing average.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector has been offered little respite in our quarterly publications of *Manufacturing Outlook* over the past few years. Unfortunately, we are still unable to forecast positive growth in output in 2021, despite the manufacturing average expectation being positive. However, the expected fall in output is significantly less severe than last year, at -1.7%. Employment in the subsector suffered approximately twice as much as the average in 2020, but a welcome light for the subsector will be the expectation of a marginal improvement in employment in 2021, bucking the negative manufacturing average trend of negativity in employment for 2021.

While experiencing a similar decline in output in 2020 to that of the Basic Metals subsector, the **Fabricated Metals** subsector expects to see positive growth in its output in 2021, forecast to be at 3.6%, which is roughly in line with the industry average. Employment, on the other hand, is a different matter. Having suffered declines in employment in 2020 approximately five times as severe as the average (employment decline of -13.8% in 2020), there is no expected recovery in employment for 2021, with a forecasted figure of -4.2%.

MECHANICAL EQUIPMENT

Having endured one of the worst declines in output in 2020 compared to all manufacturing subsectors, the **Mechanical Equipment** subsector is forecast to enjoy a bounce-back in output in 2021 at just over twice the rate of the industry average, with a growth of 9.3% expected. As often a recipient of capital expenditure, the subsector will be benefiting from increasing investment intentions as we move into 2021, following their extreme suppression throughout the depths of the pandemic in 2020. Employment is forecast to be essentially static (0.04% increase), but this is well above the -2.7% average industry forecast. However, following such a steep decline in output in 2020, the subsector will need to keep output growth consistent in order to recoup losses in real value incurred last year.

TEXTILES

Having suffered a double-digit decline in output in 2020, the **Textiles** subsector is on course to deliver the second-largest bounce back in output for 2021. A growth of 10.4% in output is forecast, which stands in contrast to the decline of -14.6% in 2020. Perhaps even more interesting is our forecast of positive employment (1.3%) for 2021, following a trend-bucking growth of 9.1% in employment in 2020. Despite suffering many of the same challenges that the pandemic has imposed on other sectors, the nature of the Textiles subsector means it is often less capital intensive than others, and this will likely allow the subsector to bounce back at a greater pace than the industry average.

PAPER & PRINTING

The **Paper & Printing** subsector outlook for 2021 is somewhat stagnant in terms of output. While a positive figure of 0.9% growth is forecast, this is markedly lower than the 3.9% percent industry average. Following double-digit declines in 2020, the subsector will have a long road ahead of it to regain the ground it lost in the previous year. Of all the subsectors we cover, this is one of our lower output forecasts for 2021. As was expected last year, despite the short-term boom in demand for packaging due to the pandemic, this has not been enough to offset the decline in output being driven by other factors. Employment in the subsector for 2021 is forecast to be negative at -2.2%, but this is less noteworthy as it is in line with the headline industry average.

ELECTRICAL EQUIPMENT

Output is expected to grow by 3.4% in the **Electrical Equipment** sector in 2021, just trailing the manufacturing average. The steady restarting of the construction sector in the UK, a key downstream purchaser of the subsector's products, has not had a large enough impact to see the electrical equipment's performance forecast to outpace the average. There is an opportunity for these forecasts to be positively reviewed later in the year, as this subsector is likely to be a significant recipient of further domestic infrastructure spend in the UK, now particularly with a renewed focus on domestic procurement following the UK's exiting of the EU. Employment, on the other hand, is forecast to be negative in 2021, at -5.3%, approximately twice as negative as the industry average.

NON-METALLIC MINERALS

We have forecast **Non-metallic Mineral's** output growth in 2021 to outpace the manufacturing average at 8.9%. Following industry average declines in output in 2020, we now expect growth to be roughly twice as fast as the rest of industry. The subsector's key purchaser is the construction industry, as products such as bricks, glass and mortar are core offerings from the subsector. The construction industry's faster-than-expected restart throughout the end of 2020 and now into 2021 has trickled down into greater than expected demand, and in turn, output volumes for the Non-metallic Minerals industry. While the subsector did experience slight positive growth in employment last year against the odds, the good fortune in output growth is not reflected in employment expectations for 2021, with a decline of -2% expected.

PHARMACEUTICALS

The **Pharmaceuticals** subsector was a stand-out industry last year, as was to be expected seeing the demand for its products skyrocket amongst the COVID-19 pandemic. Approximately one year on from the pandemic's inception that demand has now stabilised, leading to a forecast of moderate decline in output for 2021 at -4.3%. Seeing as both 2019 and 2020 saw significant output growth for the sector, the real-value lost in this industry will be less impactful as the subsector is coming from a high base. As was thought at the end of last year, we expect demand to continue to be high, but to have stabilised, hence the end of expectations of double-digit growth in output. Following an explosion of employment in the subsector in 2020 (14%), employment is forecast to decline by -3.7% in 2021.

CHEMICALS

The **Chemicals** subsector, which saw many of its products' demand spike significantly throughout 2020, not unlike the pharmaceuticals subsector, has now seen that demand begin to plateau. As a result, we have a no-change forecast for output in the subsector for 2021. We do expect demand to remain for these products for some time yet, although the frenzied need to manufacture to meet demand has calmed. Independent of the pandemic, firms within the industry have had new challenges to meet as they grapple with the REACH regulatory system now that the UK is independent of the EU. Employment, following very little change in 2020, is expected to decline significantly in 2021, at -7.7%.

RUBBER & PLASTICS

Demand in the **Plastics** industry looks set to have a steady recovery in 2021. While the increase in demand from the packaging and sanitisation market provided a demand buffer in 2020, it was not enough to offset the loss in demand from industrial plastics. Now, as demand for those industrial plastics return, so too do the prospects for the subsector in the coming year.

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. While new car registrations were at historical lows in 2020, it is expected that the situation will improve throughout the course of 2021. Together it is forecast in the **Rubber & Plastics** subsector for output to experience a 5.9% growth in 2021 with a decline of -0.9% in employment.

MOTOR VEHICLES (AUTOMOTIVE)

The **Motor Vehicles** subsector suffered staggering declines in output in 2020, transpiring to be the worst declining subsector with a loss in output of -25.6%. Despite the severity of the decline, the final figures for 2020 were actually less severe than what was expected in mid-2020. Continuing this optimism is the expected growth in output for 2021, at 24%. This means that the Motor Vehicles subsector holds the accolade of not only being the fastest declining sector in terms of output in 2020, but it is also forecast to be the fastest recovering by quite some margin. It is the only subsector that is forecast to have double-digit growth in output in 2021, apart from textiles. Notwithstanding output growth, employment is not forecast to follow suit, with a decline of 6% forecast for employment in 2021, approximately twice the manufacturing average.

OTHER TRANSPORT

The **Other Transport** subsector is comprised of the core industries Defence, Aerospace and Shipping. Not unlike the experience of the Motor Vehicles industry, this subsector experienced severe declines in its output in 2020 (-22.2%), but unfortunately, it does not come matched with expectations of a large recovery in 2021. In fact, we forecast a continued decline in output at -3.6%, albeit at a significantly less severe rate than in 2020. Employment is also forecast to worsen, with a decline of -8.4% expected for 2021. This is the most negative expected for employment in 2021 out of all of our subsectors. With little expectation that the Other Transport sector will be seeing much of a recovery this year, it will be some time before the subsector will see output levels return pre-pandemic levels.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2020	2021	2022	2020	2021	2022
Basic metals	-9.5	-1.7	0.6	-4.9	1.3	-4.4
Metal products	-9.5	3.6	3.0	-13.8	-4.2	1.7
Mechanical	-20.1	9.3	5.2	-5.1	0.04	5.0
Electronics	-7.3	3.5	3.5	2.7	-1.6	-0.5
Electrical	-11.8	3.4	1.4	-11.2	-5.3	1.1
Motor vehicles	-25.6	24.0	3.6	-10.8	-6.0	9.2
Other transport	-22.2	-3.6	10.6	-2.8	-8.4	-2.2
Food & drink	-5.7	1.7	4.8	-1.0	0.3	1.0
Chemicals	2.7	0.0	0.7	0.1	-7.7	-3.3
Pharmaceuticals	13.6	-4.3	-3.9	14.0	-3.7	-9.5
Rubber and plastics	-8.2	5.9	3.6	6.7	-0.9	3.3
Non-metallic minerals	-10.4	8.9	3.8	2.5	-2.0	2.9
Paper and printing	-11.5	0.9	1.2	-10.6	-2.2	1.1
Textiles	-14.6	10.4	-0.3	9.1	1.3	-1.4
Manufacturing	-9.9	3.9	3.0	-2.8	-2.7	0.9

Source: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

FROM STRESS TO VALUE REALISATION

After a difficult year dealing with the COVID-19 pandemic and uncertainties around the relationship with the EU, our Q1 survey results demonstrate the sector's resilience, with output, investment and confidence improving this quarter.

Government measures put in place during the pandemic have helped reduce the immediate pressure on many businesses in the manufacturing sector. However, we believe that this is unsustainable and that distress and insolvencies in the sector will rise once support packages start to unwind. For many businesses, the next 3-6 months will be critical to avoid failure. Manufacturers should be using this breathing space to assess, prioritise, plan and implement turnaround strategies, especially where difficult decisions are required.

WHAT DOES THE EVIDENCE SHOW?

A useful barometer for the current levels of distress in the sector are the corporate insolvency statistics. In 2020, insolvencies in the sector as a whole were 22% lower than in 2019. Further, our analysis of insolvency data back to 2007 shows that 2020 represents the lowest level of insolvencies in the manufacturing sector over that 13 year period.

In our opinion, there is significant risk of many manufacturers becoming stressed or distressed as the economy starts to improve. Short term survival will become critical and management teams will need to be focussed on turnaround planning and implementation.

SUCCESSFUL TURNAROUND REQUIRES PROACTIVE FOCUS

Proactive management teams are now grasping the opportunity to undertake stabilisation activities including strict cash management processes and wider stakeholder engagement. In adopting this approach, they are creating a platform from which to develop and implement a turnaround plan addressing critical immediate and medium term issues.

The successful delivery of a business turnaround requires considerable focus and it is likely that management teams will require additional support to help understand the options and define, plan and implement agreed actions.

WHAT ARE THE AREAS OF FOCUS FOR A TURNAROUND PLAN?

Turnaround plans address both operational and financial aspects and in the manufacturing sector focus is typically on the areas summarised below:

AREA OF FOCUS	TYPICAL ACTIONS
Portfolio	• Divesting or closure of underperforming business areas or subsidiaries
People	• Rightsizing the organisation in reporting tiers, shop floor and back office functions, initially with a focus on obvious overstaffing • Transitioning to more flexible working practices • Short term working
Financial	• Short term cash flow management • Debt restructuring • Working capital improvement • Asset backed lending
Customers	• Customer price increases • Removal of loss making customers • Improved cash collection activities • Minimising cost to serve
Products	• Ceasing production on non-core/low value products • Rationalisation of SKUs • Investing in new products and services in more resilient and profitable business sectors
Property	• Footprint optimisation and rationalisation • Sale and leaseback • Rent renegotiation
Operations	• Improved Sales and Operations Planning • Removal of non-value adding processes and activities • Stock reduction • Maximising asset utilisation and OEE • Insourcing production to utilise spare capacity • Outsourcing non-core process and operations • Disposal of underutilised assets • Temporary cessation on capital expenditure • Close management of discretionary overhead spend
Supply chain	• Consolidating and de-risking the supply chain • Supplier price reduction • Establishing cost effective approach to tariffs and reporting

Our guide on the three simple and effective steps to turnaround can be accessed here:

Richard Austin, Partner – richard.austin@bdo.co.uk

Chris Marsden, Partner – chris.marsden@bdo.co.uk

Stephen Cooney, Principal – stephen.cooney@bdo.co.uk

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

We stimulate success for manufacturing and technology related businesses, enabling them to meet their objectives and goals. We empower individuals and inspire the next generation.

We create the most supportive environment for UK manufacturing growth and success and we represent the issues that are most important to our members, working hard to ensure UK manufacturing remains in the government and media spotlight.

Our extensive knowledge of manufacturing means that we're able to influence policy-making at local, national and international levels. We push for the policy changes that our members want to see. We are the voice of manufacturing.

MakeUK.org

To find out more about this report, contact:

Fhaheen Khan
Senior Economist
fkhan@Makeuk.org

James Brougham
Senior Economist
jbrougham@Makeuk.org

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

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

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

Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,600 offices in 167 countries. We operate from 18 offices across the UK, employing 5,650 people offering tax, audit and assurance, and a range of advisory services.

Manufacturing is a priority sector for BDO and this focus enables us to tailor the wide range of services we offer and apply our skills and knowledge to help clients achieve their objectives.

We provide real solutions to industry issues, utilising our capabilities in everything from sector-specific tax, audit and business advice to patent box, research and development claims and acquisition opportunities to help our clients grow in the UK and overseas.

We have an excellent understanding of the issues affecting UK manufacturers as an industry sector, but we also focus on specific sub-sectors to improve our knowledge and our service to clients. These include: aerospace, automotive, building products, chemicals and pharmaceuticals, electrical, food and drink, industrials, technology and test and measurement.

Manufacturing remains one of the key industries of the UK economy. We are delighted to be able to play an active role in supporting the businesses that operate in this vibrant, changing and challenging sector.

For further information about our business and services, please visit our website: **www.bdo.co.uk**

To talk about any issues your manufacturing business may be facing please contact:

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

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

The Manufacturers' Organisation

makeuk.org

Ref: 21.03.POL.JB.NB