

In partnership with:



MANUFACTURING OUTLOOK

2019 QUARTER 2



2.7 million employees



10% of UK output



66% of business R&D



Average wages higher than the rest of the economy

Cooling System Inspector, taken by Laurence Sweeney at Egger Ltd, shortlisted in the professional category of the Make UK Photography Competition 2016.



FOREWORD



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Since 1896 Make UK has championed UK manufacturing and manufacturers. That was the same year Britain opened its first car factory in Coventry and, helpfully, the Government raised the speed limit on our roads from 4 to 14 miles per hour!

Manufacturing has been at the heart of the British economy ever since, in both good times and in bad. The recent announcements about the British motor industry and related manufacturers in the steel and aerospace sectors remind us of the challenges UK manufacturers are facing today.

This is a critical time, with many challenges as well as significant opportunities ahead. Beyond Brexit, artificial intelligence, digitalisation, automation, enhanced globalisation of markets and an ever greater demand from consumers for quality, precision and pace are all transforming the industry.

As the largest national organisation for manufacturers Make UK are more than your standard representative body – we support our sector with Brexit insights, HR and Health & Safety advice, skills training and productivity consultancy.

BDO's dedicated and highly experienced advisory services teams too have the depth of industry and technical resources to respond rapidly to manufacturers' needs.

The more you talk to us, the more we know about you.

So what are manufacturers telling us?

Well on the positive side, this quarter, manufacturing output reported by official statistics has boomed as has employment. Indeed, it was at the highest level seen since Janis Joplin topped the charts in 1971 with her song Mercedes Benz (Oh Lord).

Orders are however decreasing meaning recent output has not been driven by demand. For the second quarter in a row, domestic orders have exceeded export orders.

Wages have risen by 3.3% – 1.5% above inflation – albeit wages in manufacturing have risen by a lower 2.2% so it remains unlikely that many automotive factory workers

are going to be able to afford to buy a Merc on the back of this bonus.

But before we get driven away with ourselves...

Export orders from Asia and Europe remain near their lowest since 2016 as foreign customers increasingly move away from buying UK goods due to Brexit uncertainty.

Stockpiling ahead of the original Brexit deadline of March 29th was the highest level ever recorded in the G7. The result, as we now know from our latest figures is that imports rocketed up by 11% in Q1 this year.

Thanks to increased producer price pressures coming from oil and the tightest labour market on record, input costs went up but profit margins went down.

Looking further under the bonnet, business investment has worryingly contracted for 4 quarters in a row for the first time since the Global Financial Crisis in 2008.

Productivity growth and output per worker has also been negative for the last 3 quarters (albeit partly because of increased hiring of staff).

Despite this, and thanks to the artificial boost from stockpiling and the now seemingly reduced risk of crashing out of the EU without a deal, we have revised our forecasts for the sector up slightly to 0.2% growth in 2019 with 0.8% in 2020, while we now expect the overall economy to grow by a slightly improved 1.2% this year and 1.6% next year.

The resilience of the sector shows that manufacturing will continue to be the engine of our economy. It already contributes more in GDP terms than even financial services or construction.

Manufacturing businesses contribute nearly 3 million jobs, most of which pay above the national average, the sector contributes half of UK exports, comprises the bulk of this country's R&D spend, and the UK is today the 9th largest manufacturing economy in the world in GDP terms and as the UK continues to build on this ongoing success, BDO and Make UK are here to help.

2019Q2 HEADLINES

After the apparently stable picture reported in our Q1 *Manufacturing Outlook*, our second quarter edition shows declining – but still positive - output with orders pointing downwards in both foreign and domestic markets. This bulletin is based on the results that our members achieved in the last three months and, as a consequence, the figures include the entire month of March where a boost in activity was linked to stockpiling activities.

Confirming that at least part of the most recent output performance was related to this precautionary production, this quarter’s production balances were, for the third quarter in a row, much higher than orders. However, on a very positive note, this is the tenth quarter with output, exports and domestic balances all in positive territory.

INDICATOR	BALANCE	CHANGE	
Confidence	5.4	↑	Confidence in the UK economy slightly up since Q1
Output	17%	↓	Output balance down but still positive
UK orders	11%	↓	Domestic orders down but better than exports
Export orders	8%	↓	Export continuing to trend down at the lowest in three years
Employment	16%	↓	Recruitment balance down but still much higher than investment
Investment	6%	↓	Investment intentions very weak despite positive output

Source: Make UK Manufacturing Outlook Survey

In the next three months expectations are for a further slowdown and, if predictions are correct, we will see the closure of the gap between output and orders.

Speaking of orders, once again exports are not enjoying a great time at the moment with demand not only hit by the Brexit uncertainty but also by the global slowdown and trade tensions between China and the US. In the last report we recorded the lowest demand from Asia and Europe since 2016. This time the situation is not much different with the two markets slightly up, but demand from North America contracting.

As a consequence, employment and investment intention balances are both pointing downwards once again. As has been the case since the EU referendum, companies continue to prefer hiring rather than investing in machinery or other means, showing once more that they need confidence that such investments will be secure.

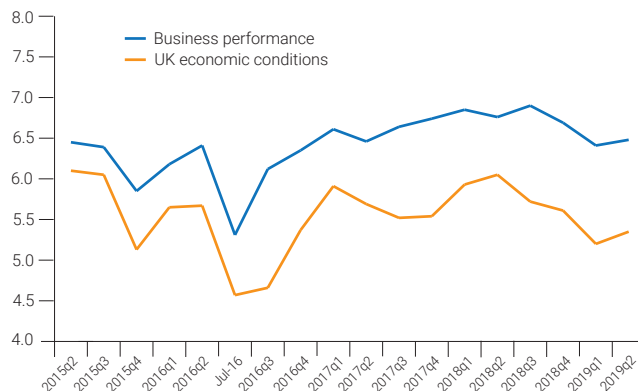
After the poor results of Q1, both business confidence and UK economic conditions have drifted up a bit having been at their lowest since 2016. This appears to be a reflection of the relief that companies experienced when the double no deal cliff edge was avoided at the end of March and in mid-April. However, the Brexit

postponement to October does not solve the uncertainty issue in a scenario already full of risks coming from all over the world.

Our forecast for 2019 is pricing in these concerns and we now predict 1.2% growth in 2019 and a slightly improved forecast for 2020 of 1.6%.

Confidence drifting up after no-deal scenario avoided

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

After two quarters of stable output at 22%, our second *Manufacturing Outlook* report of the year saw output contracting at 17%. This result was perfectly in line with expectations included in our previous *Manufacturing Outlook*. Output numbers are continuing the downward trend that started at the end of the business cycle peak in late 2017. However, despite the slowdown, this result represents the eleventh consecutive positive quarter.

It is crucial for the purpose of an accurate analysis to point out that these results also include the entire month of March, when a lot of companies increased their production, both for their own and for their clients' inventories to avoid any potential disruption ahead of the original Brexit deadline. Hence, it appears that an important part of the most recent output was related to stockpiling activities. Looking at the next three months, the prospects are less positive, with a balance pointing at 11%.

PAST THREE MONTHS	↓	17%
NEXT THREE MONTHS	↓	11%

Moving our focus to individual subsectors, resilience has encouragingly been widespread, with some areas enjoying a temporary boost from stockpiling activities.

Rubber and plastics was the top performer of our sample, also thanks to the boost it received from construction activities which enjoyed a good start to the year. The other construction suppliers, such as electrical equipment and non-metallic minerals, also enjoyed an upturn. For the near future, our members in these specific sectors expect a slowdown in the next quarter with electricals and non-metallic hitting the negative territory.

The performance of the electronics sector - the best performing subsector of 2018 – was also positive. Chipmakers are continuing to register solid balances and also have good expectations for the next quarter.

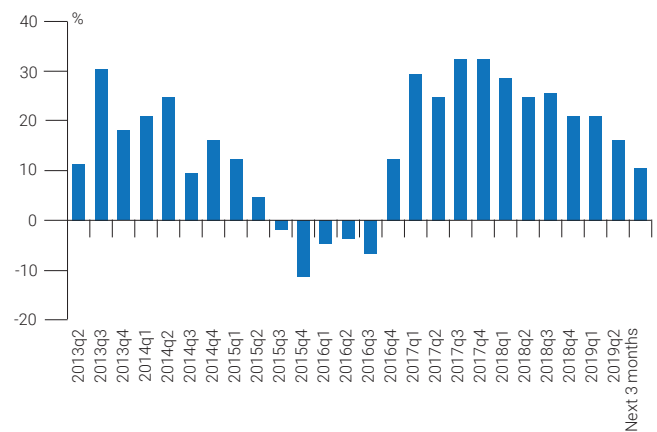
Mechanical equipment, the largest subsector in our sample, reported figures far different from the ones seen last quarter when its performance exceeded the manufacturing average. Machinery output was marginally over the zero balance and the prospects for the next

quarter is not very different, with the subsector continuing to suffer from the weaknesses related to the weakening global and – in particular – the UK investment picture.

To conclude, metal products had a good run in the quarter thanks to stockpiling activities, with basic metals struggling to expand. Expectations for the next quarter are not great, with the sector facing plenty of challenges such as with British Steel's collapse, the trade-war between US and China, and the bleak picture of UK motor vehicle production.

Output down from Q1

% 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	15%	8%
Metal Products	39%	8%
Mechanical	8%	13%
Electronics	24%	29%
Electrical	22%	-4%
Rubber & Plastics	60%	15%
TURNOVER		
£0-9m	34%	8%
£10-24m	24%	9%
£25m and over	24%	27%

Source: Make UK Manufacturing Outlook Survey

ORDERS

Total order balance halved since Q1, moving from 16% to 8%, a result well below the peak of 37% reached in the second half of 2017.

Once again, domestic orders performed better than exports and you would need to go back to the end of 2014 to find a similar result. As underlined in the previous edition of *Manufacturing Outlook*, this figure is more a reflection of the weakness of the export market than a strong domestic picture.

equipment – two major players in the economy – reporting a higher than average balance but pointing towards a slowdown in the next quarter.

EXPORT ORDERS

The story around exports has been the key theme in almost all of the *Manufacturing Outlook* reports we have produced in recent years. Back in 2017-18, export performance was responsible for the highly positive manufacturing expansion before it reverted to negative territory in the last few quarters.

UK ORDERS	PAST THREE MONTHS	↓	11%	NEXT THREE MONTHS	↑	8%
EXPORT ORDERS	PAST THREE MONTHS	↓	8%	NEXT THREE MONTHS	↑	10%
TOTAL ORDERS	PAST THREE MONTHS	↓	8%	NEXT THREE MONTHS	↓	10%

On a positive note, despite a less than strong result, this is the tenth quarter in a row where domestic, export, and total orders are in positive territory.

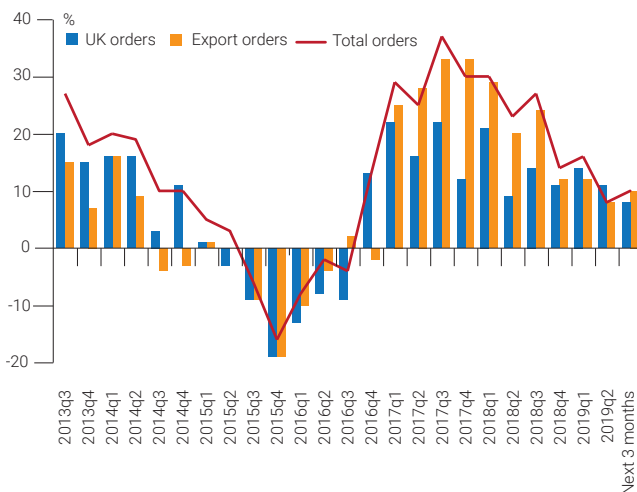
Expectations for the next three months are similar to those reported this quarter, with manufacturers predicting that exports will pick-up slightly, surpassing domestic orders. Moreover, according to Make UK members', the gap between orders and output will come to an end due to the slowdown – at least for now – of stockpiling activities.

UK ORDERS

UK orders returned to the same level reported in the last quarter of 2018. As highlighted in the past, domestic orders have recently followed a less dramatic boom and bust cycle when compared to exports. The slightly calmer trajectory has helped domestic orders to reach a record of eleven consecutive quarters in positive territory.

Total balance down with domestic still better than exports

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

Most subsectors are reporting a result over the zero threshold, but there are some important exceptions. In particular, the basic metals sector reported the bulk of its difficulties coming from the domestic market with a strongly negative balance at -31%, and another expected negative quarter in the next three months. On the other side of the spectrum, food & drink and chemicals both had a good quarter, with metal products and mechanical

The situation in Q2 is quite similar to that reported in Q1, with companies having trouble with their export partners. This is due to said export partners either delaying their orders until complete clarity on Brexit is found, or, as seems more likely, to foreign customers changing their supply chains to avoid relying in future on the British market.

Order balances from foreign markets have declined to 8% from the 12% reported in both Q4 2018 and Q1 2019. The figure is now getting closer to negative, an area which it has not been in since the end of 2016.

Compared to domestic orders, more subsectors are reporting a negative or flat export balance. Basic metals is one example, with a balance of 0% and extremely negative prospects for the future, clearly related to tariffs from the US and a lack of pick-up in demand anywhere other than Europe. This is with some clients likely relieved after a few months of trade unburdened by the danger of delays at customs.

A picture of positivity and stability is instead seen in the electronics sector, which continues to get most of its fortune from external markets. However, despite the positive result, the sector is one of the most exposed to the mounting trade tensions between the US and China. While these two countries started their ongoing trade war over steel and aluminium, it is now clear that the fight has been extended to new technologies. This could, in turn, disrupt the extremely global electronics supply chain. Looking at market pick-up, it appears that some of these fears have already materialised, with requests from Asia and North America at very low levels compared to the past.

Broadly speaking, manufacturers continue to see Europe as their main market even though demand from the continent is weakening.

Orders summary

% balance of change

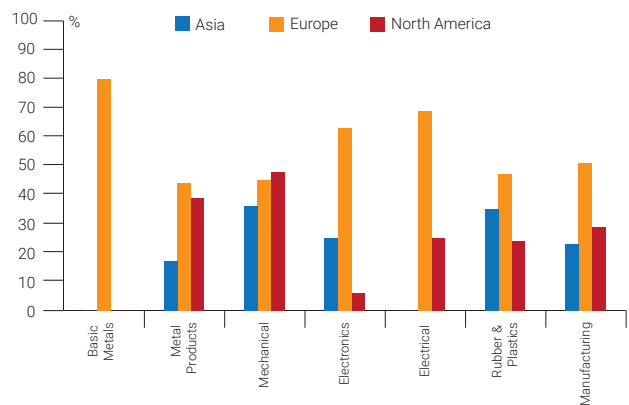
SECTOR	UK ORDERS		EXPORT ORDERS		TOTAL ORDERS	
	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals	-31%	-15%	0%	-42%	-46%	-15%
Metal Products	26%	9%	19%	9%	31%	8%
Mechanical	16%	9%	9%	18%	8%	10%
Electronics	16%	13%	23%	24%	24%	25%
Electrical	9%	14%	-10%	5%	35%	17%
Rubber & Plastics	10%	5%	39%	17%	21%	5%
TURNOVER						
£0-9m	14%	4%	4%	-2%	15%	7%
£10-24m	11%	5%	25%	12%	14%	10%
£25m and over	26%	20%	24%	31%	27%	25%

Source: Make UK Manufacturing Outlook Survey

The export market top three is then completed by North America, and Asia, which has claimed back its third place position following a quarter in which third place was occupied by the Middle East. This, however, is not the result of an Asian recovery but rather a small decline in export orders from the Middle East. As a matter of fact, the balance reported in both markets is weak compared to what we used to see, confirming that the next potential Brexit cliff edge (on 31st October) is not the only risk that UK manufacturers have to deal with.

Trade tensions are impacting business

% of companies reporting positive demand conditions by market



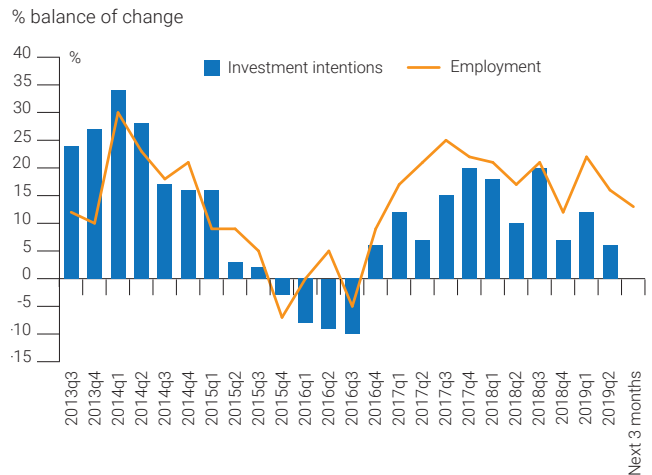
Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

The pick-up seen in the last quarter – possibly related to the temporary boost that stockpiling activities demanded – has faded away with both employment and investment intentions down but above the 0% threshold.

Once again, as has consistently been the case since 2015, employment intentions are still higher than investment intentions, with companies more willing to hire than invest in other, less fungible, resources. This is also clearly reflected in the official data, which reports all the main labour stats at their best since records began. However, as we underlined in the May edition of our Pay Bulletin, several of the new hires are for part-time jobs or contracts involving self-employed workers.

Investment and employment down after last quarter's temporary boost



Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT	PAST THREE MONTHS	↓	16%	NEXT THREE MONTHS	↓	6%
INVESTMENT	NEXT TWELVE MONTHS	↓	13%			

Despite a couple of spikes, the current balance for investment is in line with the downward trend started at the end of 2017, and following a trajectory also seen in the official data. Interestingly, the gap between output expectations and investment is also shrinking, pointing to a labour market that is too tight to fill the lack of investment that has characterised the period since the EU referendum in June 2016. Indeed, employment expectations are also down as a result of recruitment difficulties and worrying order books.

The weak result that basic metals reported for both orders and output was also reflected in the negative balance for employment (-15%) and a flat investment. The other subsectors – despite not being in negative territory – are also pointing toward a weak investment picture. Electronics is, however, above the manufacturing average with just 17%, despite the great expansion of a year ago and a still resilient order book.

To highlight once more how uncertainty about the post-Brexit future is impacting firm-level performance, the subsectors reporting very good output – rubber & plastics, metal products, electricals – all have investment intentions at zero or very close to it.

Employment and investment summary

% balance of change

SECTOR	EMPLOYMENT		INVESTMENT
	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	-15%	15%	0%
Metal Products	24%	7%	8%
Mechanical	16%	15%	11%
Electronics	4%	13%	17%
Electrical	30%	30%	0%
Rubber & Plastics	15%	16%	6%
TURNOVER			
£0-9m	18%	17%	15%
£10-24m	10%	12%	-2%
£25m and over	24%	13%	21%

Source: Make UK Manufacturing Outlook Survey

PRICES & MARGINS

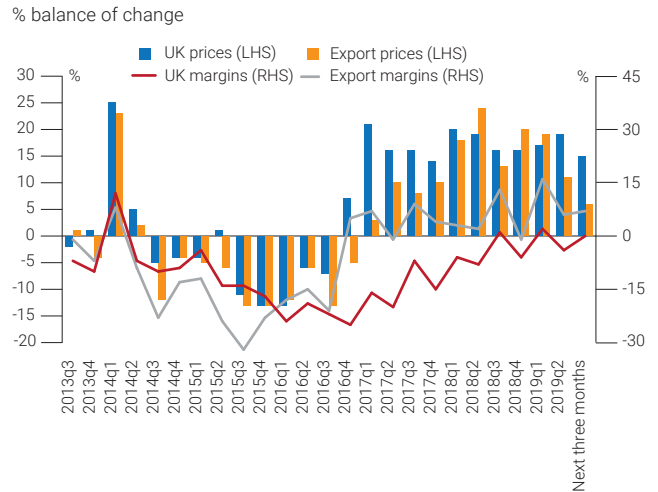
The second release of the year saw UK and export prices moving in different directions, with the first drifting up to 19% and the second drifting down to 11% respectively.

Despite UK prices increasing, margins are still reported to be better in the international markets rather than at home, with UK margins once again in negative territory.

Expectations for the next quarters are that of declining prices and a feeble pick-up in margins.

The divergence in margins between UK and export markets is not a new story, with manufacturers who are focused on the domestic markets being squeezed by the cost of inputs coming from abroad but for which they pay for using currently weak sterling. Manufacturers also face a market where consumers, despite accepting some rises in price, are not yet ready to accept the entire cost increase.

UK margins are once again in negative territory



Source: Make UK Manufacturing Outlook Survey

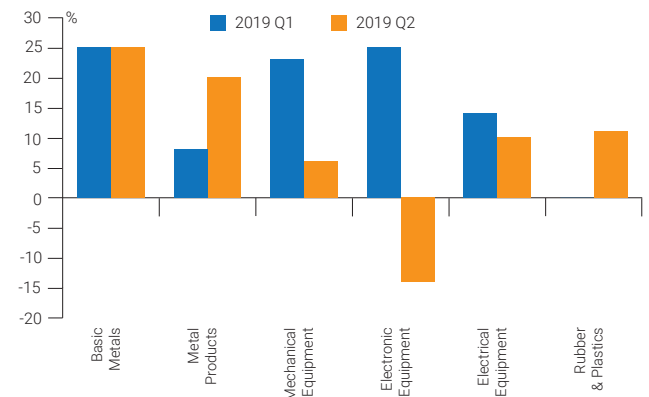
Category	Period	Change	Value	Next Three Months	Change	Value
UK PRICES	PAST THREE MONTHS	↑	19%	NEXT THREE MONTHS	↓	15%
EXPORT PRICES	PAST THREE MONTHS	↓	11%	NEXT THREE MONTHS	↓	6%
UK MARGINS	PAST THREE MONTHS	↓	4%	NEXT THREE MONTHS	↓	0%
EXPORT MARGINS	PAST THREE MONTHS	↓	6%	NEXT THREE MONTHS	↑	7%

This trend is also clearly reflected in official data, which keep pointing to input prices running much faster than output and consumer prices. In the following months, the price of Brent – which continues its erratic behaviour mirroring the constant flow of worrying trade news coming from around the globe (the US, Iran, Saudi Arabia, Venezuela and elsewhere) – will be crucial for future prices and margins. In the first five months of the year, oil prices had an average price of \$66 per barrel, ranging from a minimum of \$53 to a maximum of \$75.

Another key point, as always, will be sterling’s valuation which was weakened in the last few weeks, due to the most recent Brexit event and which continues to be extremely weak for big importers of commodities and raw materials.

A mixed bag of results for exporters

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

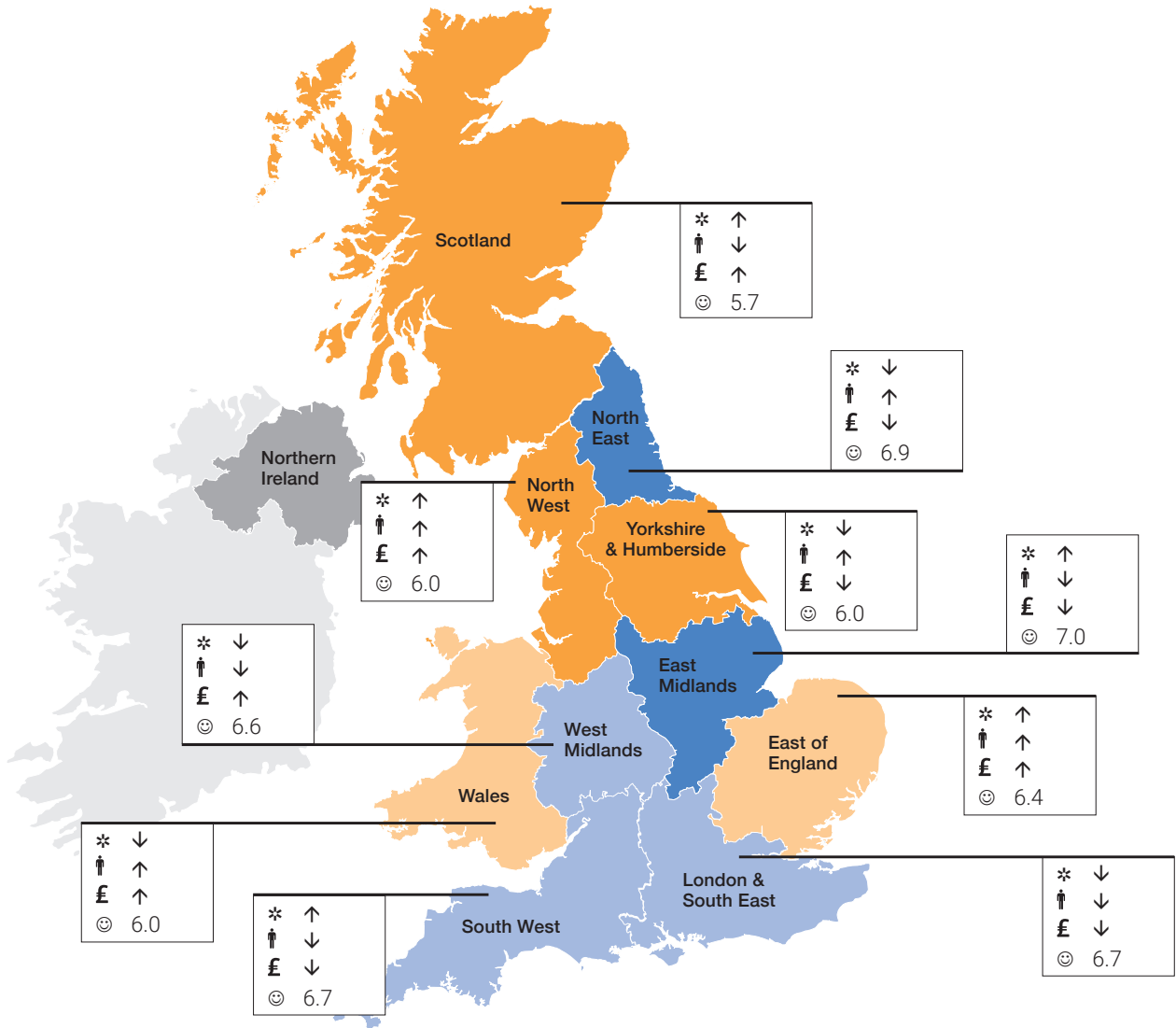


Source: Make UK Manufacturing Outlook Survey

REGIONAL

Business confidence is positive in all regions this quarter, but we have seen confidence levels drop for half of them this quarter. Output was positive around the country, with some very high output figures in a few select regions.

As previously mentioned, it is likely these positive output figures are to some degree misleading, as they can still be put down to the stockpiling effect caused by the previous Brexit deadline in March.



- KEY:
- ↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
 - * OUTPUT
 - 👤 EMPLOYMENT
 - £ INVESTMENT
 - ☺ BUSINESS CONFIDENCE

The map is coloured according to business confidence levels

Source: Make UK Manufacturing Outlook Survey

The North West and the East of England had a positive quarter with their balances for output, employment and investment all rising upwards compared to Q1. The North West was likely helped by the strength of the chemicals sector in the region. The East is one of the few regions in our sample that did not see output outstripping orders, which suggests that stockpiling is not entirely behind the recent rise in output. The resilient electronics sector is likely influencing the overall number of orders.

The South East and London might look to have had the worst quarter, with reductions on all three measures, however, things are not as dire as they may seem. Despite the fall, output, orders and employment do remain positive, but less so than when we asked three months ago.

The East Midlands is worth highlighting this quarter as it saw the biggest difference between output, which was incredibly high (52%), and orders (14%). The region's largest manufacturing sector is Food & Drink, so it's likely that once again stockpiling is leading to the chasm between outputs and orders.

Employment, though down compared to last quarter in several regions, still remains in positive territory everywhere except the South West which saw a negative balance.

BUSINESS CONFIDENCE INDICATORS

We saw an increase in confidence levels in six of the regions since last quarter's survey. It's likely that

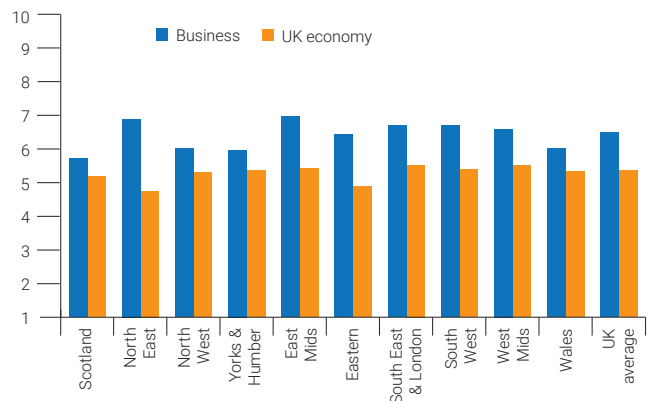
the announcement to move the Brexit deadline back contributed to this boost in confidence.

Scotland maintains its place at the bottom of the business confidence chart. Both Yorkshire & Humberside and Wales fill out the rest of the bottom three. The South East and London lose their top spot this quarter, replaced by the East Midlands, with the North East just behind.

Confidence in the UK economy as a whole also saw a small pick-up keeping it on the positive side of the scale. The Eastern and North East regions are the most pessimistic, with their confidence in the UK at the negative end of the scale.

Firm level confidence remains positive but down on last quarter

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



Source: Make UK Manufacturing Outlook Survey

Regional summary

% balance of change

REGION	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	42%	14%	27%	16%	19%	11%
North East	24%	10%	21%	0%	7%	18%
North West	24%	16%	14%	10%	19%	-5%
Yorks & Humber	28%	41%	28%	26%	34%	11%
East Mids	52%	27%	14%	14%	21%	32%
Eastern	22%	12%	26%	12%	26%	19%
South East & London	18%	11%	11%	18%	11%	7%
South West	42%	8%	25%	17%	-8%	0%
West Mids	13%	29%	29%	57%	0%	38%
Wales	26%	3%	10%	4%	17%	18%

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

UK GDP expanded by 0.5% in the first quarter of 2019 continuing the rollercoaster ride the economy has been on since the start of 2018, with the succession of good and bad quarters such as the meagre 0.2% expansion of the last quarter of 2018 and the +0.7% in Q3. The latest performance was positive and it was linked to strong private and government consumption but also stockpiling activities which pushed manufacturing activity high in the first quarter.

The threat of a no-deal Brexit had a very large effect on trade and stock-building numbers with imports of goods up by a whopping 11% and inventories contributing 0.6 percentage points to growth in Q1. If these weren't peculiar enough, the surge of imports also included non-monetary gold which contributed 1 percentage point to GDP growth. All these factors are expected to calm in the next few months and it must be pointed out that both the contribution from inventories and non-monetary gold are GDP neutral since they are offset by the negative contribution of imports.

Looking ahead, our forecasts were lightly revised since Q1 with GDP growing by 1.2% in 2019 and 1.6% in 2020. Once again, our forecast is based on a "soft Brexit"

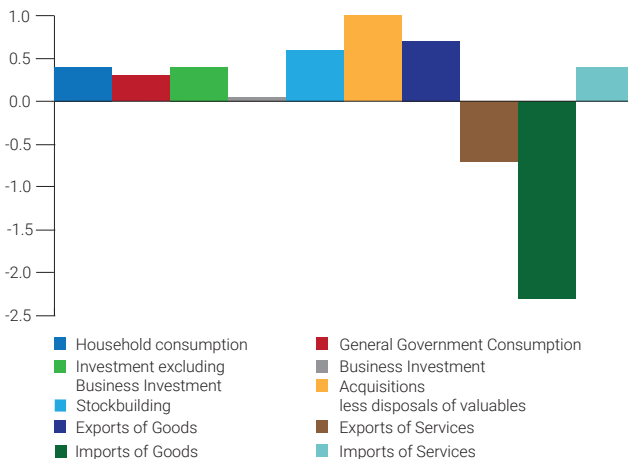
HEADLINES:

- The UK economy continues to experience modest but resilient growth despite Brexit uncertainty and other threats to global trade. A moderate pick-up is expected in 2020.
- Households continue to spend thanks to inflation remaining mostly on target
- The labour market is still showing very good headline figures, but digging deeper points to a less rosy picture
- Investment to drop in 2019 after four quarters of contraction in 2018. Recovery is expected for 2020 if the Brexit situation is finally resolved

Despite the fact our assumptions are still for a "soft Brexit", the uncertainties around the form the UK's EU departure will take have already had a clear impact on business investment. As we pointed out in our previous *Manufacturing Outlook* editions, business investment has stopped its post financial crisis recovery and

Stockbuilding heavily impacted Q1 numbers

Contributions to GDP growth in ppts%



Source: ONS and MakeUK analysis (2019)

contracted in 2018 even though the economy grew by 1.4%.

Moving the cliff-edge back, originally from 29th March to 12th April and then to 31st October avoided a potentially very dangerous situation for several UK companies, in particular in the manufacturing sector. However, postponing the date did not end the uncertainty, meaning the expected bounce back in investment has also been seen.

At the household level, consumers have continued to spend with private expenditure growing at a decent pace. Our forecast sees consumption continuing to be the largest contributor to growth with an expected increase of 1.5% this year and 1.6% next year.

Looking at trade, the big surge in imports in the first quarter related to stockpiling and non-monetary gold, had a large impact on our forecasting and, though we were expecting an almost flat net trade contribution in 2019 and 2020, we now expect to have this kind of balance in a two year horizon with a negative balance in 2019 and a positive one in 2020.

On monetary policy, the Bank of England will continue to await Brexit certainty before acting (and only if necessary). Moreover, all the major central banks around the globe appear to be less keen on tightening lending,

owing to a world economy which no longer appears to be running as fast as in 2017 and 2018.

HOUSEHOLD CONSUMPTION WILL CONTINUE TO CONTRIBUTE TO GROWTH

Private consumption in the first quarter of 2017 saw strong growth (+0.7% compared to the previous quarter) – the highest increase since Q1 2017. Despite extremely low confidence, consumers are enjoying the positive effect of a high employment level and of an inflation on target which is translating into real wage growth. However, it is likely that part of this consumption growth is also related to households anticipating some increased expenses ahead of the first Brexit deadline. This appears to be evident in the retail sales numbers for pharmaceutical products, alcohol, and toiletries which all saw strong increases in the first quarter of 2019 but will likely return to normal in the next quarter.

LABOUR MARKET HEADLINES CONTINUE TO BE STRONG BUT MIGHT MASK SOME ISSUES

While the economic headlines over the past year haven't been great, labour market statistics have bucked the trend, going from strength to strength with unemployment touching an all-time low of just 3.8% in Q1 2018 and employment and inactivity rates also the best on record.

However, survey data are pointing towards a slowdown in hiring. Official numbers also show how the recent expansion has been driven mostly by temporary contracts and self-employment, confirming how companies are continuing to be cautious about hiring in case of a bad Brexit.

In terms of wages, the acceleration of last year appears to have slowed down particularly as a result of CPI being below target and productivity continuing to underperform with the last three quarters showing a contraction in output per hour. We still expect wages to grow by 3% in 2019 and 2.8% in 2020 however the growth will be lower in manufacturing, continuing a divergence which has been clear for the last year.

ANY POSSIBLE INVESTMENT BOUNCE-BACK HAS BEEN PUT ON ICE, AGAIN

The other side of the labour data coin is the UK's very poor performance in terms of business investment. In 2018 business investment saw an alarming four quarters of contraction resulting in an overall 0.4% decline in the

UK Economic forecasts

% change except where stated

	2018	2019	2020
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.14	1.15
Exchange rate (\$/£)	1.34	1.30	1.37
Exports	0.2	2.2	2.4
Imports	0.8	4.8	0.2
Current account (% GDP)	-3.9	-4.3	-3.3
OUTPUT			
Manufacturing	0.9	0.2	0.8
GDP	1.4	1.2	1.6
COSTS AND PRICES			
Average earnings	2.9	3.0	2.8
Oil price (Brent Oil \$/bl)	71.1	70.8	67.7
EMPLOYMENT			
Manufacturing (000s)	2,715	2,700	2,658
Rest of economy (000s)	32,373	32,715	32,945
Unemployment rate (%)	4.1	4.0	4.0

Source: Oxford Economics and Make UK

year. Companies reported holding off investment plans until Brexit is done and dusted so moving the deadline back to 31st October means that we can't expect a pick-up in 2019 yet. For this reason Make UK have revised down our forecast to -1.5% in 2019 and pencilled in a weaker rebound at 1.7% in 2019.

Looking at trade, figures in Q1 were extremely unusual and not only for the impact non-monetary gold had on total data. Import and exports of goods spiked up whereas trade of services contracted. Looking at the table breakdown, trade in chemicals and pharmaceuticals, food products and beverages spiked up confirming how precautionary stockpiling had a large impact on numbers. We expect this one-off effect to disappear in the next months with trade figures returning to normal levels if a smooth Brexit is agreed.

GLOBAL ECONOMY:

- The global economy to slow down amid trade tensions
- The eurozone is struggling but Q1 data are better than expected
- The US continues to do well but is facing important risks
- Iran-US tension are impacting oil prices

According to the latest estimates, world GDP grew by 3.6% in 2018 – a performance slower than 2017, but still positive. Predictions for this year are for a further slowdown with an overall growth of 3.1% due to several factors involving emerging and developed markets.

The number one risk concerns trade tensions between the US and China. The consequences of a full blown trade war would be detrimental not only to the two countries involved but also to several economies around the world which are already feeling the pressure of reduced demand, particularly affected manufacturing. At the time of writing, the Trump administration has enacted new tariffs on Chinese goods with the “red dragon” ready to retaliate. Trade tensions also had a strong effect on equity markets which experienced a lot of volatility over the news coming from both sides of the Pacific Ocean.

Looking at Europe, after the difficulties reported in the last two quarters of 2018, the eurozone was able to grow by 0.4% in Q1 with both Germany and Italy reporting a

decent growth after the technical recession Italy suffered and the one Germany narrowly avoided. Looking at the coming months, PMI indexes are not pointing to positive prospects for manufacturing but they are still looking good for the services sector confirming once again how the weakness in the global economy so far has been mostly a manufacturing story.

As Europe starts to struggle once again with its long-standing weak growth problem, the other side of the Atlantic continues to grow fast with the latest numbers pointing to a 0.8% expansion in Q1 but the US economy is going to face very important challenges in the coming quarter. The first is surely the aforementioned trade war with China and the second will be the end of the fiscal boost the Trump administration gave to the economy in the recent past. If this was not enough, renewed tensions with Iran are affecting the global oil price on top of the never-ending proxy-war between Iran and Saudi Arabia impacting the Middle-East.

International Economic forecasts

% change

	GDP			INFLATION		
	2018	2019	2020	2018	2019	2020
US	2.9	2.6	1.7	2.4	2	1.8
Eurozone	1.8	1.3	1.5	1.8	1.4	1.4
France	1.6	1.4	1.5	1.9	1.2	1.3
Germany	1.5	1.1	1.6	1.7	1.5	1.6
Japan	0.8	0.5	0.4	1	0.9	1.2
China	6.6	6.3	6	2.1	2.3	2.5
India	7.4	7	6.9	3.9	3.8	4.9
World (2015 PPPs)	3.6	3.1	3.4	3.2	3.2	3.1

Source: Oxford Economics

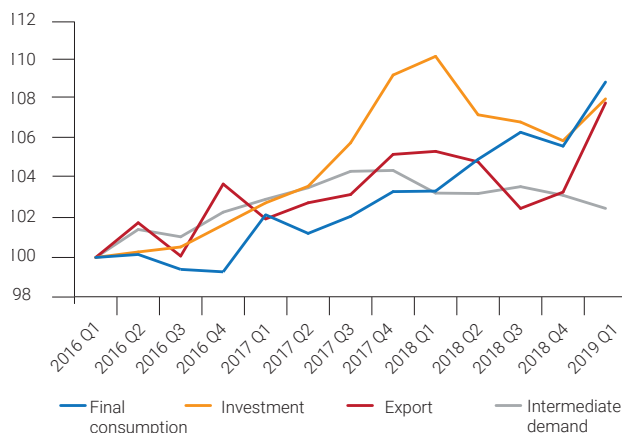
SECTOR FORECASTS

After 2018 concluded with the manufacturing sector growing by 0.9% and characterised by a very broad range of results, with some sectors such as electronics doing extremely well and others such as electricals performing very poorly, the first quarter of 2019 started with growth figures much stronger than their natural trend and higher than orders would have pointed to. As underlined in the economic environment section, stockpiling activities played a huge role in this upturn.

The sectors most exposed to stockpiling showed the highest increases in Q1 with pharmaceuticals growing by more than 9%, chemicals more than 3%, and food & drink – a sector usually not subject to spikes – up by more than 2% in the quarter. Figures for these sectors were also extremely high in terms of exports and imports from and to the EU, with companies trying to increase their stocks ahead of the original 29th March EU exit deadline and to avoid any potential delays or disruptions.

Those more exposed to intermediate demand are showing a worrying picture

Real GVA growth of sectors most reliant on a single type of demand (2016Q1=100)



Source: ONS

The chart above points out the positive impact the stockpiling spike had on the sectors most reliant on consumer, export, and investment demand. The same did not happen to intermediate demand which might, once again, point towards an impending slowdown in activities in the next coming months. Intermediate goods are those

used as inputs in production, so a slowdown in the growth of these goods also indicates a slowdown in orders and future output.

We expect the stockpiling effect to retreat in the coming quarter as the threat of a no deal Brexit has been abated (for now). However, we do believe that the effect might be gradual with some companies choosing, in certain cases out of necessity, to keep their stock level high. For this reason, we revised our 2019 forecast up but our 2020 forecast down. We now expect manufacturing to grow by 0.2% in 2019 and by 0.8% in 2020.

STOCKPILING IS ARTIFICIALLY BOOSTING HEAVILY REGULATED SECTORS

The top performer of the quarter was the **pharmaceutical** sector which saw an incredible 9.5% growth in the first quarter of 2019. The sector is well-known for its erratic behaviour. However such high growth is also unusual for this sector. Due to the importance of the products it produces, and the heavy regulations these goods are required to comply with when traded, companies increased their production and dispatches to full speed to meet the expected 29th March deadline. We expect output levels to go back to their normal level in the coming months and we think that the sector will grow by 3.4% to then contract by 0.7% in 2020.

A similar story concerns the **chemicals** sector. The EU's overarching Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) regulation could potentially create more to complications for companies willing to trade with the EU after Brexit. The need to stockpile REACH compliant chemicals for fear of a no deal Brexit cutting off supplies pushed up trade with the EU to a very high level in Q1 with exports growing by almost 11% and imports by 9%. The sector increased its output by more than 3% in the quarter thanks to the particularly good performance of agrochemicals and petrochemicals. Paints and varnishes, the chemicals subsector which is most reliant on motor vehicles orders had by contrast a weak quarter, suffering as a consequence of the widely publicised negative news headlines about the UK auto sector. Overall, we now expect a 2% expansion in 2019 and a minor contraction (-0.4%) in 2020.

CONSUMERS ARE CONTINUING SPENDING AT A DECENT PACE

In the economic environment section, we underlined how consumers have continued to spend despite low levels of confidence. The results can be seen in sectors reliant on domestic consumer spending.

Food & beverage, the largest UK manufacturing subsector, had a very good first quarter with growth at 2.7%. Such a fast increase for the sector is significant and we need to go back five years to find a stronger result. The sector is usually one of the most stable due to the nature of its products and to the fact that it is not very exposed to foreign markets (only 9% of total demand). Such strong growth can only be explained by stockpiling activities in anticipation of the Brexit deadline. We expect output to go back to its usual trend in the next quarter and to end the year with 2% growth and follow that with 1.3% growth in 2020.

The **textiles** industries also received a boost from stockpiling activities and export orders, which firms rushed to complete ahead of March 29th. Exports to the EU grew by almost 10%, again with very good results from several other markets. After the temporary boost, the textiles sector will continue to face once again its usual problems with margins squeezed due to customers not accepting higher prices and input prices going up. We expect the sector to stay almost flat this year and to contract by 2.4% in 2020.

After concluding the year with a small contraction, the **paper & printing** sector grew fast in the first quarter. The boost will probably lead to a consequent slowdown in the next period, however, the sector may continue to enjoy the growing transition from plastics to paper products as consumer pressure builds for more environmentally friendly packaging and other goods. We expect the sector to grow by 0.3% this year and by 0.6% in the next.

Electricals was the worst performer of 2018 with a contraction of more than 7%. This came as a result of the weakness of the construction sector at the beginning of 2018, the delays for some important power plant projects, and the low consumer appetite to buy major appliances. While the first quarter of 2019 was very positive for this sector, we believe that the growth in 2019 and 2020 will be only marginal.

CONSTRUCTION SUPPLIERS SHOWED A MIXED BAG OF RESULTS

Despite the good first quarter for construction activities and the growth achieved by almost all manufacturing sectors, the **non-metallic mineral** sector had a difficult first quarter with a very sharp contraction almost entirely wiping out the result achieved in the last quarter of 2018. We expect the sector to recover some ground and to end the year with 1.3% growth in 2019 and 1.4% in 2020.

Despite the move from single-use plastics and the weakness reported by motor vehicles, **rubber & plastics** had a strong first quarter of the year thanks to the construction sector. We expect the sector to expand in both 2019 and 2020.

The **basic metals** sector is another important supplier for construction however, its situation is currently driven more by other areas of the economy. The British Steel crisis is expected to have important repercussions on the sector's performance and this comes on top of growing global trade tension with new tariffs having been applied to steel and aluminium. The **fabricated metals** sector is not exactly in a much better position with one of its main clients – the motor vehicles sector – facing a very difficult time. Despite the bounce in Q1, we expect both the metals sectors to contract in 2019.

MECHANICAL EQUIPMENT IS SUFFERING FROM THE WEAK INVESTMENT PICTURE

The investment picture continues to look very weak in the UK and not too strong elsewhere either with the investment cycle clearly on the downside. The consequences of this is being borne mostly by the **mechanical equipment** sector which made its fortune in 2017 – when it grew by 9.6% – thanks to exports boosted by weak sterling and the global appetite for investment in machinery. The first quarter of the year also saw a contraction and we expect a sharp contraction in 2019 before a bounce back in 2020.

The **electronics** sector was also affected by lower investment demand. However, compared to the mechanical equipment sector, its future picture is less bleak. The sector enjoyed double digit growth last year and despite the threats coming from the trade war between the US and China, which might hurt its highly-integrated global supply chain, the electronics sector can still exploit the high demand for automation and new technologies coming from around the globe. We don't expect a

repetition of the amazing 2018 performance, in part due to the recent weakness in semi-conductors sales, but we believe that the sector will expand by 1.9% in 2019 and 1.2% in 2020.

THE TRANSPORT SECTOR IS SHOWING A VERY HETEROGENEOUS PICTURE

After the 5.3% drop reported in Q4, the **motor vehicles** sector reported another quarter of negative growth. The sector continues to suffer more than others over the uncertainties surrounding Brexit. The trade war between the US and China and weak car registration figures in the UK and Europe are also contributing to the difficult situation. We expect a sharp contraction this year at -4.3% and a small bounce-back in 2020. As highlighted above, the sector is also having detrimental effects on several other sectors closely linked to it.

The rest of the transport sector – **other transport** – is still reporting a good performance with a very long pipeline of orders, which should guarantee future output despite some risks related to Boeing 737 safety concerns and the Bombardier plant in Northern Ireland being put up for sale. Our forecasts are for a growth over 3% for 2019 and 2020.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2018	2019	2020	2018	2019	2020
Basic metals	-2.7	-1.8	0.3	4.4	-2.6	-1.1
Metal products	0.7	-1.6	0.3	4.9	0.3	-0.9
Mechanical	1.8	-3.6	2.0	2.8	-1.1	0.5
Electronics	10.0	1.9	1.2	-0.5	-2.8	-1.2
Electrical	-7.6	0.6	0.2	-0.1	-7.9	-3.9
Motor Vehicles	-1.5	-4.3	1.3	2.9	4.1	-0.3
Other transport	2.8	3.1	3.4	0.2	2.0	-1.0
Food and drink	1.8	2.0	1.3	2.2	2.4	-1.4
Chemicals	0.3	2.0	-0.4	-3.1	-0.6	-4.6
Pharma	4.3	3.4	-0.7	2.3	-1.2	-7.5
Rubber and plastics	0.8	1.0	0.9	4.7	-1.5	1.5
Non-metallic minerals	-1.7	1.3	1.4	-2.6	-0.3	-1.6
Paper and printing	-0.2	0.3	0.6	-1.4	-2.6	-2.9
Textiles	-0.2	0.3	-2.4	-2.0	-7.7	-5.5
Manufacturing	0.9	0.2	0.8	1.1	-0.6	-1.6

Sources: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

HELPING TO SOLVE THE UK PRODUCTIVITY PUZZLE THROUGH MANUFACTURING DIGITAL TRANSFORMATION

One of the biggest economic challenges facing the UK is our stubbornly low levels of productivity. GDP per hour in the UK increased by just 1.1% between 2008 and 2016 compared with 8.5% in the United States, 7.4% in Japan and 6.5% in Germany.

Investment is crucial to improving UK manufacturing's productivity, and it is particularly significant now given the need for manufacturers to embrace the fourth industrial revolution (4IR) and their digital transformation.

Disappointingly, the Q2 Manufacturing Outlook report shows manufacturers' investment intentions have contracted for four quarters in a row for the first time since the global financial crisis in 2008.

With ongoing uncertainty, manufacturers have seen it safer to hire labour than invest in machinery and technology. This may have helped solve a short-term problem but means the sector's progress towards becoming digitally-focused for the long term has stalled.

SO HOW TO RESOLVE THE UK'S PRODUCTIVITY PUZZLE?

In BDO's recently published Manufacturing Digital Transformation survey, 83% of UK manufacturers saw productivity as the main positive impact of digital transformation.

As a key sector for the economy, manufacturing can help drive significant productivity gains in the UK but only with the right government support.

1 – The right investment in skills and education is vital and increased support for apprenticeships and vocational training will have a big impact. But 84% of UK manufacturers in our recent survey said the Government must do more, with 78% stating the education system is failing to deliver the right STEM skills for the future. In addition, 81% said there needs to be more education on 4IR and digitalisation.

2 – Further investment in carefully selected government-supported infrastructure is another way to boost efficiency and productivity. There should be greater focus on projects and improvements in existing infrastructure. For example, 48% of UK manufacturers think that the Government needs to invest in a full fibre digital infrastructure to enable better digital connectivity. We also need genuine government support for more powerful regional centres such as the Northern Powerhouse and the Midlands Engine.

3 – In our New Economy Report we called for a simplification of the tax system to encourage productivity growth and 52% of manufacturers agreed. We proposed that the government places a moratorium on UK corporate tax changes until 2022 or when the Brexit transition period is over (whichever comes first) to give businesses some certainty in difficult times.

But before this freeze is implemented, we would like to see one significant change: an increase in the annual investment allowance (AIA). If the Chancellor could find it in his coffers, an increase to £5m for the next five years would provide a major incentive for manufacturers to invest in capital assets and boost their efforts towards greater digitalisation.

Increasing the AIA to £5m would more than double projected business investment growth and could increase labour productivity almost five-fold by the end of 2023.

Companies need to prepare for a more digitally-fluent, productive future both in terms of the people they employ and the technologies they deploy. Clear government action is needed or UK manufacturing will be at risk of investment paralysis as the uncertainty of Brexit drags on.

To download BDO's *Digital Transformation Report 2019*, visit <https://www.bdo.co.uk/en-gb/manufacturing-digital-transformation-report>.



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We're delighted to introduce Make UK, the new name for EEF, and our family of new brands including Make Business and Make Venues. Together they will support the needs and requirements of our vibrant sector and ever-changing marketplace.

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

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

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

MakeUK.org

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The data used in this survey have been provided by UK manufacturers including members of Scottish Engineering 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 162 countries. We operate from 17 offices across the UK, employing 5,000 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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