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MAKE uk The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2024 QUARTER 1

With support from:

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FOREWORD

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Prime Minister Rishi Sunak kicked off the week of the Spring Statement with a speech at a construction site in Swindon.

That's nothing unusual for the occupant of No. 10 in Budget week, albeit the customary yellow hard hat was conspicuously absent.

The backdrop of his speech, once the site of a World War Two aeroplane factory, is now undergoing transformation as diggers and cranes work to demolish Swindon's old Honda factory.

The previous factory occupied approximately 2.2 million square feet. The new carbon-neutral facility will expand its size significantly, reaching 5.5 million square feet and employing more than 7,000 people when finished. This expansion will be achieved through the construction of 11 buildings tailored to meet the needs of modern manufacturers.

It is a shining example of how, after years of economic uncertainty, manufacturers are now keen to invest in the opportunities offered by advances in AI, automation, digitalisation, and the transition to Net Zero.

Industry investment was the major theme of the Spring Statement too. Chancellor Jeremy Hunt led with an attack on the cost-of-living crisis, but he also incorporated important initiatives aimed at assisting the business community. The key announcement in the Autumn Statement was that Full Expensing was being made permanent. HM Treasury followed that up this time with a commitment to include leased assets in the future. The message is clear for manufacturers, and it's a message they appear to have heard when one looks at the results of this quarter's *Manufacturing Outlook* survey.

While most measures remain flat compared to last quarter, our investment measures show the most signs of improvement. Conventionally, stable scores that show little sign of growth suggest businesses will shy away from investing in capital stock or adding to their headcount, but many manufacturers say they intend to increase their headcount and expand their factories despite the economic slowdown.

Indeed, the survey findings show that output volumes and order books posted only small positive balances indicating growth has been achieved for a minority of the industry. For the rest, output growth over the last twelve months has been mixed at best, with many manufacturers consistently raising their hopes of a positive "next" quarter, even whilst orders seemed to suggest that decline was on the horizon.

Following strong signs that higher interest rates were successfully cooling rampant inflation, the latest figures suggest there has been an increase in the number of manufacturers passing price increases onto their customers. There is a risk that if manufacturers continue to increase their prices to protect their profit margins amid escalating input costs and the decline in orders, the economic impact on the sector will be negative. Forecasts for the short and medium term are not very encouraging, with manufacturing output growth expected to fall behind the wider economy for the foreseeable.

Nevertheless, there is positive news that manufacturers are increasing recruitment, a recognition that labour and skills shortages remain one of their biggest barriers to growth. Furthermore, the incentives to invest which the Chancellor encouraged by making full expensing capital allowances permanent has translated into improved intentions to increase capital expenditure on plant and machinery. Investment is a key component of improving growth and productivity. Despite declining demand, as indicated in our survey results, many firms understand correctly that if they continue to improve their production teams and facilities, they will find themselves better prepared to respond to any future increase in customer orders.

Traditionally, fiscal events in the run up to an election tend to prioritise enhancing household budgets over supporting business concerns. Yet while this Spring Statement might not have heralded much by way of significant media headlines, it may mark the start of a turnaround for the UK economy.

Neither party has yet finished constructing their manifestos but from now until the General Election there will not be a factory in a swing seat left unvisited by politicians in hard hats seeking to persuade the public they can rebuild the economy out of the current recession. Make UK will be making the case for including a commitment to a long term sustained Industrial Strategy as a central part of that plan and if this edition of *Manufacturing Outlook* is anything to go by, many firms are eager to invest in the building blocks of economic growth too.

HEADLINES

This quarter's Make UK *Manufacturing Outlook* report, in partnership with BDO, shows the manufacturing sector continues to perform well despite challenging economic conditions. Although there are few indications of standout performances, the results are in line with current expectations as the UK economy shows material signs of slowing down due to rising interest rates and higher costs for both businesses and consumers.

The latest balance of output is at +5%, down from +20%, indicating a substantial share of businesses have experienced declining output volumes, although across the industry a small percentage of manufacturers reported improved output volumes. As order books showed strong signs of slowing down towards the end of 2023 it was inevitable that output volumes would follow suit with manufacturers making more efficient use of their inputs. As expected, order books are set to improve for the next quarter and so manufacturers are planning to expand their output to meet forecasted demand. Whether this demand will be realised remains to be seen.

Order books have stagnated in recent quarters, and the same is the case for the latest result, a +7% balance for total orders, unchanged from Q4 2023. Nevertheless, the survey findings indicate a return to normal business conditions to some extent. With order cutbacks may inevitably take place but demand for labour remains strong. Investment intentions have also improved on balance to +15% indicating that manufacturers are investing in building capacity despite falling orders which suggest there is a belief the opportunities for growth exist.

The share of manufacturers raising prices on their goods has increased this quarter for both UK and Export goods, which is surprising given the trends set by 2023. On the other hand, margins worsened despite those price rises suggesting that manufacturers are working hard to shield their earnings, but costs may yet again be rising at a rate that is challenging to respond to in time.

Business confidence remains positive despite both output and order books showing only mild growth. Manufacturers are increasingly demonstrating resilience to adversity which has made it much less likely for our confidence metric to shake across the sector. As a result, recent survey results have shown that the emergence of new crises, such as supply-chain disruptions caused by uncontrollable factors are having limited impact on confidence. Indeed, optimism in business confidence has remained positive for 15 quarters back-to-back. Confidence in the UK economy has improved this quarter although manufacturers are more wary of external economic conditions given the UK is currently in a recession.

INDICATOR	BALANCE	CHANGE	
Confidence	6.7	↑	Business expectations maintain positivity
Output	5%	↓	Output volumes growth slows markedly
UK orders	1%	↑	Domestic orders expands slightly
Export orders	1%	↓	Export orders slows from last quarter
Employment	12%	↑	Jobs growth maintains momentum despite slowdown
Investment	15%	↑	Investment activity expected to improve

Source: Make UK Manufacturing Outlook Survey

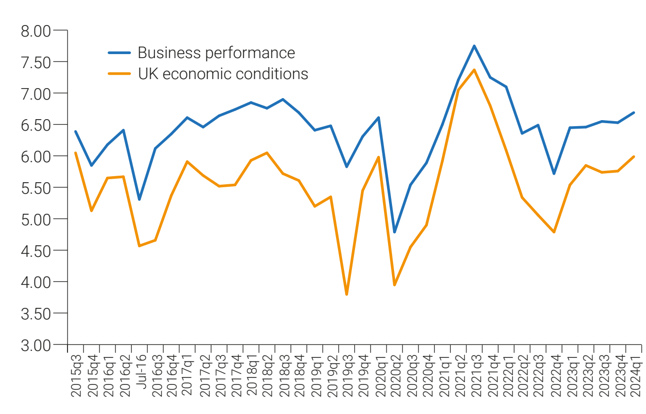
books exceeding the balance for output growth as last quarter manufacturers were seen to be over producing.

Although, some challenges remain, such as high energy costs, persistent labour shortages, and access to inputs which are becoming increasingly difficult due to tensions in the Red Sea, drought in the Panama Canal, and the ongoing War in Ukraine which have all impacted logistic networks. Splitting the performance of order books into domestic and export orders finds that the potential trend cast by the final quarter of 2023 did not carry forward. Both UK and export orders reported a balance of +1%, which suggests an improvement for the former but a slowdown in activity for the international markets. This is unsurprising given major importers of UK goods, such as Germany and France are underperforming on economic growth with their respective manufacturing industries feeling the impacts of inflation and international instability.

Employment, however, reported more positively at +12% which is double the balance reported in Q4 2023. Though rising interest rates may lead to an increase in unemployment, manufacturers are showing little signs of willingness to cut back on staffing. Some

Manufacturers' expectations maintain positivity

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

Manufacturing Outlook's core sector performance metric, output, delivers a modest balance figure in comparison to what was posted in the final quarter of last year. Nevertheless, the previous figure has transpired to be just a flash in the pan, and this quarter's figure, albeit in single digits, is still higher than what was reported in the third quarter of 2023.

As is seen across a range of metrics this quarter, mildly positive yet flat performance is so often the flavour of this edition's research. While expectations set last quarter were for there to be a drop in performance for output this quarter, actual performance has come in beneath the sector's already low forecast.

With only a marginally positive balance figure of +5% for output this quarter there has been little positive change in its production prospects over the past three months. This figure is 15 percentage points lower than the previous quarter's, albeit the previous figure was an unexpected high.

In keeping with the robust positivity and consistency that we observe in our separate confidence metric, expectations for the next quarter are also surprisingly positive, especially given the modest order volumes the sector is reporting. Manufacturers have posted an expected balance figure for output in Q2 of +31%, which is almost twice as ambitious as the previous expectation set last quarter.

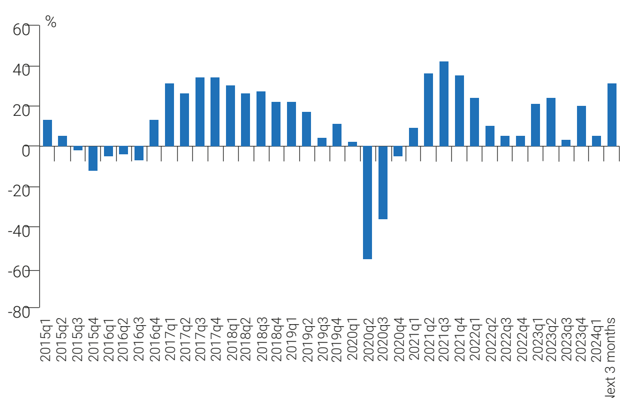
Disappointing order books throughout the second half of 2023 have weighed on the sector's ability to produce up to capacity, with this being likely to continue until strength in demand returns. A return of demand may not be too far away, however, as so much of the suppression in trade has been driven by heightened central bank rates both here and abroad. With the monetary policy mood likely to ease as we move through 2024, this will likely unshackle some pent-up demand for the sector's products, allowing output to grow again, at least to a degree.

Our survey has witnessed over two quarters of heightened expectations which have not come to pass. This, combined with the expectations for the wider UK economy in the coming months, leaves us dubious that the expectation for Q2 output performance will meet its lofty ideals of +31% on balance as expected by the industry. Nevertheless, these repeat expectations for strong growth in this metric, even if missed, reveal that the sector thinks that the bleak demand conditions are to pass anytime soon.

PAST THREE MONTHS	↓	5%	NEXT THREE MONTHS	↑	31%

Output growth slows as future expectations improve

% 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	0%	-33%
Metal Products	-18%	24%
Mechanical	14%	35%
Electronics	33%	33%
Electrical	0%	39%
Rubber & Plastics	-22%	22%
TURNOVER		
£0-9m	6%	37%
£10-24m	-9%	21%
£25m and over	11%	37%

Source: Make UK Manufacturing Outlook Survey

ORDERS

A strong pipeline of orders has supported the manufacturing industry since early 2021 as global economies began to reopen their doors and consumers were eager to spend their pent-up savings. However, the previous two quarters of activity have indicated a marked slowdown in the balance of manufacturers reporting increasing order books. There is a concern that the sector could be heading for stagnation on its current trajectory.

The survey's findings for the start of the new year suggests that the industry is getting by with a small balance of business reporting growth in orders, and output. Though the level of growth indicated is by no means worthy of celebration, it is encouraging to observe the sector moving forward in the absence of extreme case events like the Covid-19 pandemic or the energy cost crisis. Certainly, the level of activity observed over the last few quarters indicates a sense of calm, though manufacturers will be more wary of potential new storms.

The latest balance of +7% for total orders is unchanged from the previous quarter. More frequent reports of declining order books are concerning as the backlog of pent-up demand has showed strong signs of drying up, particularly as higher interest rates restrict activity. The good news is that slowing demand will enable the central bank to achieve its goal of slowing the rate of inflation as price growth will be restricted in tandem, but this may come at the cost of higher unemployment which will no doubt fuel concerns of a more severe recession.

However, based on manufacturers' expectations for the next quarter, slowing demand has had little impact on optimism, with a positive balance of +24% of manufacturers expecting total order books to improve over the next three months. However, it is worth keeping note that manufacturers in recent quarters have consistently overestimated their order performance which suggests that there is an awareness that pent-up demand still exists in the marketplace, but other unidentified variables may be delaying the growth.

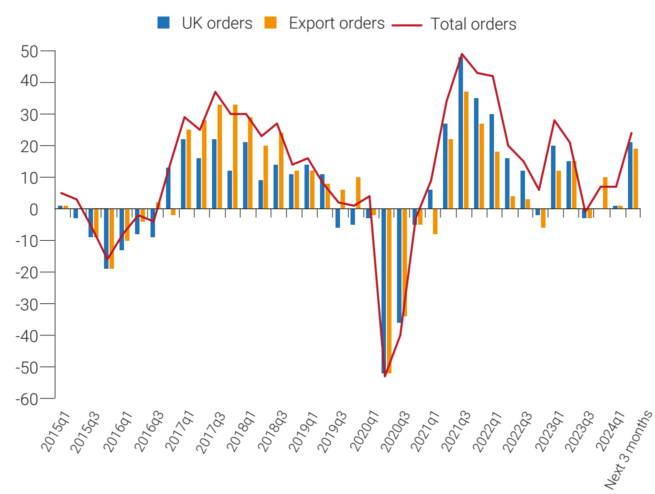
UK ORDERS

UK orders reported a relatively improved balance of +1%, following last quarter's flat 0% balance. Domestic market performance has been a saving grace for the manufacturing sector since mid-2020, but the slowdown in total order books has been partially driven by a slowdown in the UK market. This was the case in the previous quarter as export orders outperformed UK orders by a wide margin, though the same is not true for this quarter as exports have slowed in line with domestic activity. The signs point towards a more global slowdown in activity, not exclusive to the UK, as many partner nations have also tightened interest rates to tackle inflation.

UK ORDERS	PAST THREE MONTHS	↑	1%	NEXT THREE MONTHS	↑	21%
EXPORT ORDERS	PAST THREE MONTHS	↓	1%	NEXT THREE MONTHS	↑	19%
TOTAL ORDERS	PAST THREE MONTHS	↔	7%	NEXT THREE MONTHS	↑	24%

Order books continue to slow down, but manufacturers expect growth in Q2

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

The results for the sub-sectoral breakdown lean more on the positive side, with only some producers of intermediate goods experiencing a contraction on balance. The Electronics subsector, which caters to the production of high-tech goods, such as automation technologies, reported a strong +33% balance of growth for UK orders. This is good news, particularly as the Government extended 100% capital allowances for plant & machinery investments which may have partially influenced the resurgence in demand for electronic goods. In contrast, the Metal Product subsector reported declining UK orders, with a -31% balance of manufacturers affected.

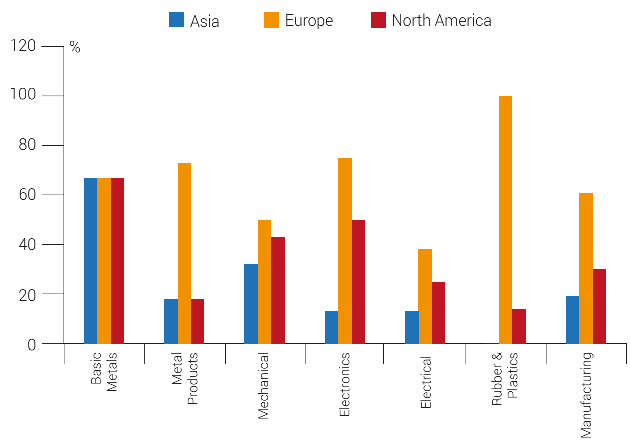
EXPORT ORDERS

Following a strong report for export orders at the end of 2023, orders from the international markets has slowed from a balance of +10% to +1%. Though the European Union remains the most important market for UK manufacturers, businesses continue to report difficulties in trading due to burdensome levels of administrative work, such as custom forms and completing rules of origins paperwork. Yet, 2024 will be a critical year for manufacturers as the UK Government works to secure trade deals with countries including India and Canada. These negotiations will be critical to the success of UK manufacturing, particularly because negotiations on import controls are to restart this year.

Finally, our survey results find that activity remains strong from the EU, with 61% of UK manufactures reporting positive demand conditions from the region, an increase from 56% last quarter. This is followed by the North America region with 30% reporting positive demand conditions. The top three is completed by Asia, though only 19% of businesses indicated positive conditions.

Demand conditions remain strong in Europe

% 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	0%	0%	33%	33%	0%	67%
Metal Products	-31%	16%	-22%	16%	-16%	16%
Mechanical	5%	23%	8%	15%	14%	30%
Electronics	33%	0%	29%	43%	33%	22%
Electrical	12%	38%	0%	15%	11%	11%
Rubber & Plastics	44%	67%	-11%	33%	22%	67%
TURNOVER						
£0-9m	5%	26%	0%	15%	9%	33%
£10-24m	-2%	18%	0%	21%	7%	28%
£25m and over	19%	40%	10%	33%	22%	47%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

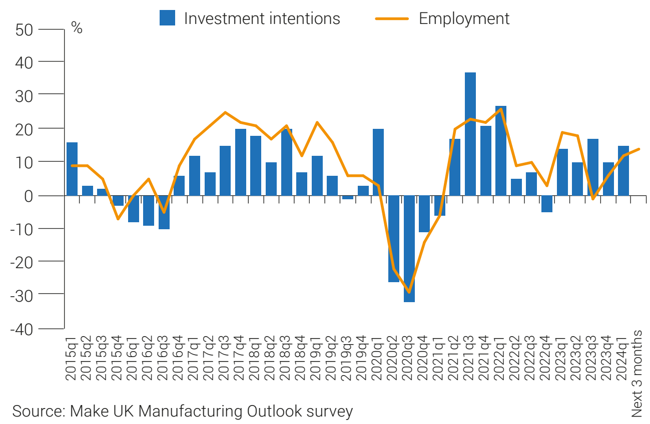
Manufacturing Outlook's Employment metric is one of the few in this edition, along with Investment Intentions, that reveals some positive news for the sector, albeit modest. Two quarters ago the sector's hiring activity was tantamount to a hiring freeze. This was brought about by a sudden shock to the sector as to just how intensive interest rate pressures would become in the middle of 2023, but this hiring aversion has eased since then and this quarter's data illustrates that well. Nevertheless, vacancies in the sector still remain high relative to their historical average, indicating that a labour shortage persists in the UK industry.

The sector reported a balance figure for employment of +12% this quarter, which is an increase of 6 percentage points compared to the fourth quarter of last year, indicating that manufacturers are making some progress towards filling vacant positions. Expectations for improved employment balance figures next quarter are present also, with a figure of +14% expected next quarter.

of a sector that is expecting a 'break' to manifest soon, likely to present in the first instance as the start of a decline in central bank rates, cheapening the cost of capital and making investment more accessible to a wider spread of the sector.

Employment expands as manufacturers prepare to increase investment

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑	12%	NEXT THREE MONTHS	↑	14%
INVESTMENT	NEXT TWELVE MONTHS	↑	15%			

As of January 2024, there are currently 68,000 (to the nearest thousand) live vacancies in the UK's manufacturing sector, which is a slight decrease from the 69,000 reported in the previous edition of this report. As a ratio, that is for every hundred jobs in the sector, 2.8 are vacant, which is the same ratio that was reported last quarter. This figure is approximately 50% higher than the long-run average for the twenty years prior to 2020, illustrating the consistently elevated demand for labour in the sector since the pandemic.

The investment intentions metric, which measures manufacturers' plans to invest in human and/or physical capital over the coming 12 months, has improved since last quarter. The balance figure increased from +10% in the final quarter of last year, to its current balance of +15%.

The positivity exhibited in investment intentions for the year ahead bodes well for the sector, even if the shorter-term metrics are less celebratory. This intention to invest over the coming year, and the growth in its sentiment, is indicative

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	**PAST THREE MONTHS**	**NEXT THREE MONTHS**	**NEXT TWELVE MONTHS**
Basic Metals	-33%	33%	33%
Metal Products	2%	8%	6%
Mechanical	18%	9%	4%
Electronics	-11%	10%	30%
Electrical	5%	21%	33%
Rubber & Plastics	-11%	-11%	11%
TURNOVER			
£0-9m	4%	18%	13%
£10-24m	2%	2%	3%
£25m and over	14%	18%	18%

Source: Make UK Manufacturing Outlook Survey

PRICES & MARGINS

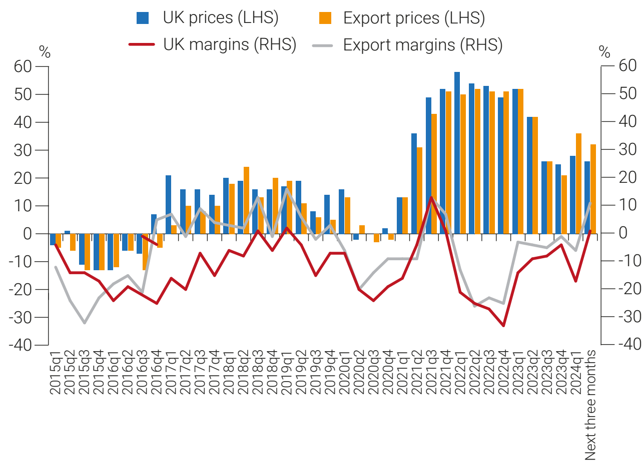
In a rather surprising move for the Prices metric, the sector has indicated that, on balance, prices have been raised by a larger share of manufacturers compared to the last quarter, in contrast to following the downward trajectory that had been exhibited for over a year. Since the first quarter of 2023, one year ago, *Manufacturing Outlook's* Prices metrics, which track the price-setting behaviour of UK manufacturers for both their domestic and export customers, have been reducing the rate at which prices have been rising. At no point in that period has the metric indicated that prices have fallen in absolute terms, but rather the rate of the increase was slowing significantly.

This has been in keeping with the expected effects of the elevated base rate set by the Bank of England, and indeed is one of the main objectives of the Bank's rate-setting behaviour, to slow and ultimately end inflationary spirals. So despite this, the sector posting a higher balance figure for the Prices metric comes as a surprise and bucks the trend of the past four consecutive quarters.

UK price-setting behaviour and Export price-setting behaviour have both risen relative to last quarter, with the former posting a balance figure of +28% and the latter a

Manufacturers raise prices in Q1 in an attempt to shield declining margins

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑	28%	NEXT THREE MONTHS	↓	26%
EXPORT PRICES	PAST THREE MONTHS	↑	36%	NEXT THREE MONTHS	↓	32%
UK MARGINS	PAST THREE MONTHS	↓	-17%	NEXT THREE MONTHS	↑	1%
EXPORT MARGINS	PAST THREE MONTHS	↓	-6%	NEXT THREE MONTHS	↑	11%

figure of +36%. However, the UK prices metric has only increased a little, by 3 percentage points, since last quarter, but the Export prices metric has almost doubled in scale, rising by a significant 14 percentage points.

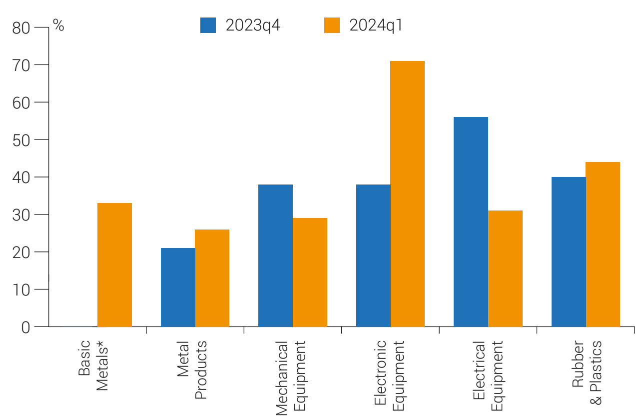
Expectations for price setting behaviour next quarter remain roundly consistent, with small declines in the figures expected in each case. However, the forecasts do not suggest that the trends will return the slowing of price rises observed towards the end of last year.

What explains some of this sudden increase in pricing behaviour is explained by our complimentary Margins metric, which has seen declines in both UK market margins and Export market margins. The declines in UK market margins have been more pronounced.

When we compare where price changes per market, it would appear the more intensive price-rising behaviour for export markets is cushioning declining margins better than is seen in the domestic price-margin relationship.

Industry raises prices on capital goods and materials for exporting

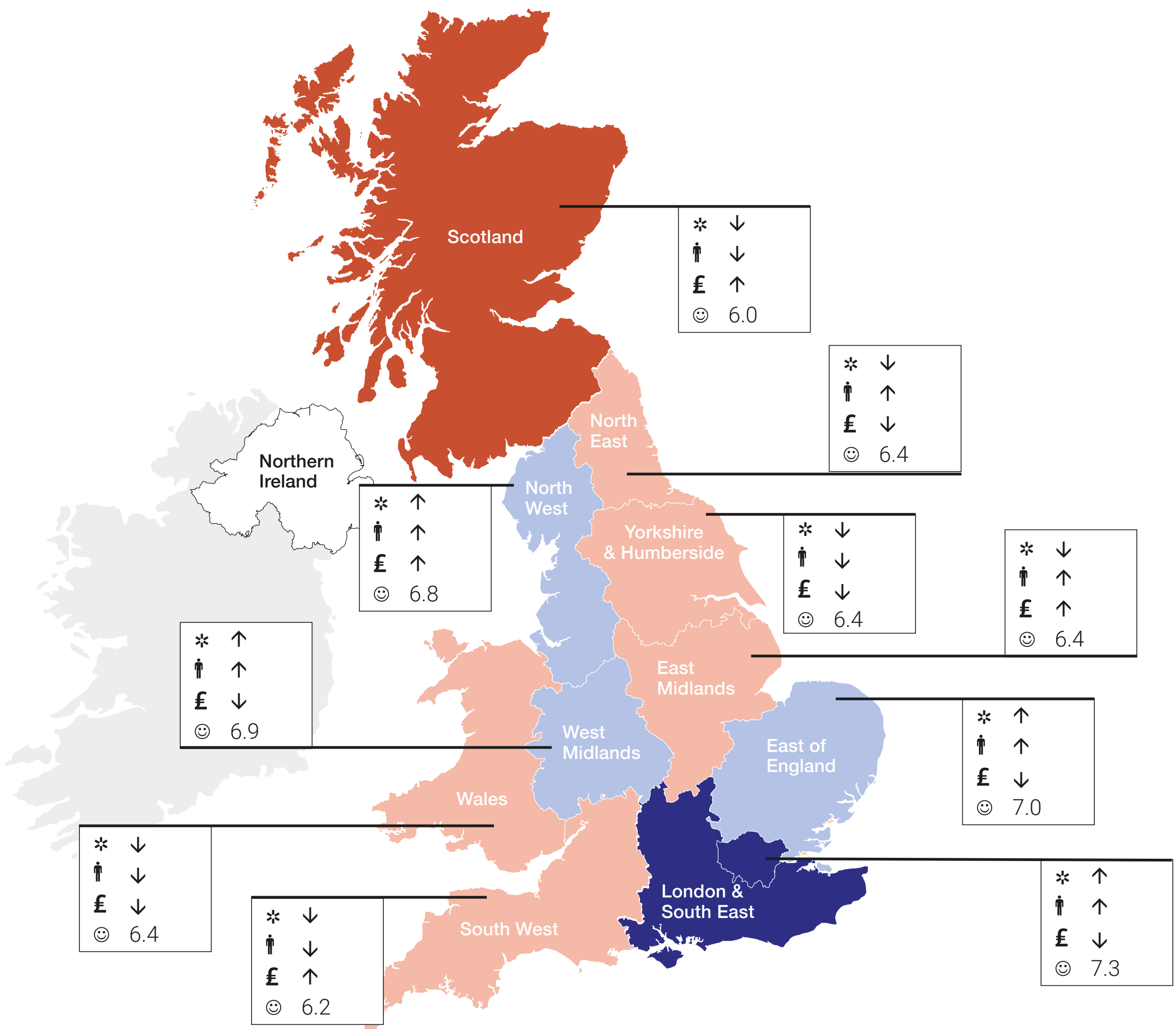
% balance of change in export prices in the past three months



Source: Make UK Manufacturing Outlook Survey
* insufficient sample for Q4 2023

NATIONAL & REGIONAL

Confidence continues to maintain its position in moderate positivity, despite slowdowns in order books and declining margins. In the last few years, manufacturers have faced several crises that have tested their ability to adapt their practices and continue growing.



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
✲ OUTPUT
EMPLOYMENT
£ INVESTMENT
☺ BUSINESS CONFIDENCE

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

HIGH CONFIDENCE

LOW CONFIDENCE

Source: Make UK Manufacturing Outlook Survey

The metrics for optimism in our Q1 *Manufacturing Outlook* report indicates that manufacturers' resilience to economic uncertainty and crises have improved substantially. Even as interest rates rise, order books slow down and supply-chain disruption worsens, manufacturers appear almost unfazed by the possibility of an economic downturn. Indeed, the metric for confidence in business conditions have maintained a positive level (above 5 for 15 quarters in a row now although, the metric for UK economy confidence has maintained a positive confidence level for 5 quarters in a row.

This highlights how manufacturers have great confidence in their own ability to deal with future crises as many businesses have built in a higher degree of risk readiness into their operations. Still manufacturers will need to be wary of persistent uncertainty as most businesses were shielded by strong order books in the last several years which they may no longer be able to rely on if current trends continue.

Headline business confidence reported at 6.7, which is a small improvement on last quarter's level (of 6.5.

Compared to the national average, Scotland has the lowest business confidence amongst all regions and nations at 6.0. However, the confidence level remains above 5 indicating that manufacturers are still quite optimistic about the UK. Furthermore, there is little variation in the average confidence level for manufacturers of the different regions and nations which suggests that most businesses have improved their resilience to crises.

The largest improvement in business confidence was reported by the East of England, which increased by 0.8 point to 7.0. The region with the highest business confidence in the UK is the South East and London, reporting at 7.3. The next two most confident regions are the East of England and West Midlands, the latter reported its confidence level at 6.9.

Within the regions of England the largest decline in confidence was reported by Yorkshire & the Humber, where it fell by 0.5 to 6.4.

Nevertheless, these regions and nations fortunately remain positive despite the mixed experience for output, employment and investment. For example, despite reporting a high confidence level, the Yorkshire & the Humber region reported declines in output and orders on balance highlighting a performance that is below the national average.

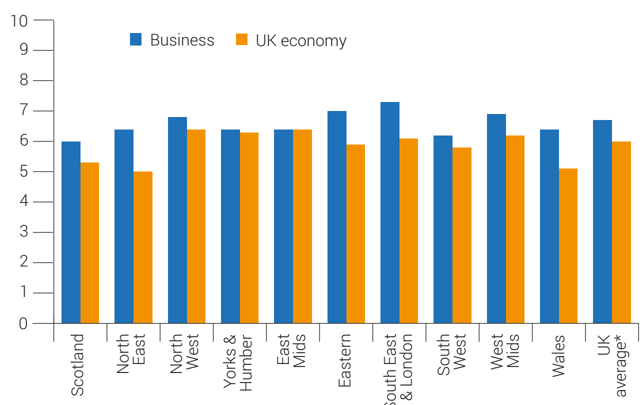
UK ECONOMY CONFIDENCE

Manufacturers' confidence in the overall UK economy reported at 6.0, a small improvement on the previous quarter level (of 5.8).

Despite official statistics indicating that the UK economy is now in a technical recession, manufacturers' optimism of wider economic conditions has improved slightly. It may suggest that manufacturers are aware that the recession, whilst valid in a technical sense, is not a significant one and likely to not be long lasting. As a result, manufacturers are proceeding with business-as-usual.

All UK regions and nations report positive business confidence

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



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

Source: Make UK Manufacturing Outlook Survey.

Regional summary

% balance of change

	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
REGION	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	5	43	9	35	6	23
North East	13	25	13	13	13	0
North West	0	14	7	7	14	0
Yorks & Humber	-21	29	-29	21	0	-7
East Mids	-23	23	5	27	18	32
Eastern	5	25	26	45	-5	10
South East & London	37	23	44	39	14	3
South West	-12	12	6	24	-18	0
West Mids	4	46	14	57	15	7
Wales	29	43	43	71	14	14

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

The economic environment has changed significantly in the last few years with manufacturers adapting to a new mode of working within a higher cost and higher risk state of the world. Despite the challenges due to many external, uncontrollable factors such as the tensions in the Red Sea and drought in the Panama Canal increasing supply-chain disruption, manufacturers continue to strive forward by investing in energy efficiency, innovation, and skills.

Nevertheless, the biggest question businesses are now asking is: is the UK really in a recession? The Office of National Statistics (ONS) recently revealed that the UK experienced two back-to-back quarters of negative growth in the second half of 2023, with a 0.1% and 0.3% fall in GDP across the third and fourth quarters respectively. This is a technical recession, albeit a small one. The economic contractions were not unique to manufacturing as the services sector also declined highlighting a wider economic slowdown rather than a sector specific scenario.

This recession is historically likely to be one of the UK's weakest downturns, and one that is likely to be short-lived as business expectations remain robust despite order books slowing down. Furthermore, whilst manufacturing output declined overall in the final quarter of 2023, the sector achieved growth in both November and December 2023 indicating that it was back on a positive trend. As a result, it is possible that the recession will be over by the second quarter of this year. This will, however, depend partially on the performance of key partner countries that the UK trades heavily with, such as Germany, France, and the US.

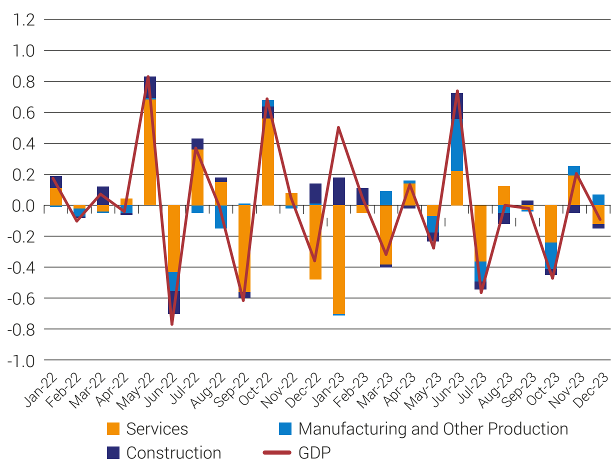
The latest GDP forecasts for other major economies indicate that most developed countries are expected to grow in 2024, according to forecasts produced by Oxford Economics. Except for Germany, which is on track for a 0.1% decline in GDP as its economy struggles with high energy costs, slowing order books and is relatively more affected by the sanctions imposed against Russia. By contrast, the US is expected to achieve GDP growth of 2.3%, in line with the forecast growth for the world average at 2.4%. In contrast, the Eurozone is only expected to grow by 0.6% which is in line with the current forecast for UK GDP growth in 2024. As these forecasts indicate, whilst most countries are unlikely to experience a true recession, many, including the UK, are showing signs of stagnating with industries struggling to break the ceiling of mediocre performances.

This cycle may be difficult to break this year, as the political climate remains uncertain with the UK, and the US, preparing for their national elections. The potential outcomes of these critical events are difficult to predict with the incumbent and opposition parties both vying for support from households and businesses. From manufacturing's perspective, what is needed to break this cycle is a long-term industrial strategy that puts business at the heart of achieving prosperity in the UK.

Inflation remains a concern for businesses this year, despite the rate of price rises easing sharply in recent months. The headline rate for consumer prices currently stands at 4%[1] which is still two times greater than the Bank of England's target level. However,

UK enters a recession following two consecutive quarters of negative growth

Contributions to monthly GDP, percentage points, January 2022 to December 2023



Source: ONS

current forecasts indicate that the rate of growth in prices should ease to around 2% in 2024, although the overall price level remains higher than it was pre-pandemic. As a result, the cost-of-living crisis will continue to persist as wage demands increase, and the cost of imported inputs remains volatile.

Indeed, supply-chain challenges are increasingly becoming the focus of manufacturers' woes as tensions in the Red Sea echo the problems logistic organisations faced during the Suez Canal blockage. Manufacturers are now reporting lead times increasing on average by two to three weeks, and even upwards of 90 days in some cases. The challenge is that this creates bottlenecks across the supply-chain as the delay of one component of even simple products can result in increasing lead times for goods that are indirectly impacted by the limited capacity of global freight lines. This will inevitably result in higher costs for manufacturers which will make it even more difficult to shield declining margins. Despite this challenge, manufacturers remain very optimistic as the adoption of new technologies, and the prospects of trade deals with non-EU nations presents opportunities for those willing to take the risks.

[1] Consumer price inflation, ONS (February 2023).

UK Economic Forecasts

% change except where stated

	2023	2024	2025
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.15	1.17	1.16
Exchange rate ($/£)	1.27	1.27	1.29
Exports	-0.3	0.1	2.8
Imports	-1.3	2	3.3
Current account (% GDP)	-2.6	-2.5	-2.6
OUTPUT			
Manufacturing	1.0	0.1	0.8
GDP	0.3	0.6	1.6
COSTS AND PRICES			
Average earnings	7.4	4.4	2.7
Oil price (Brent Oil $/bl)	82	76	77
EMPLOYMENT			
Manufacturing (000s)	2,603	2,571	2,540
Rest of economy (000s)	36,689	36,705	37,107
Unemployment rate (%)	4.1	4.5	4.3

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

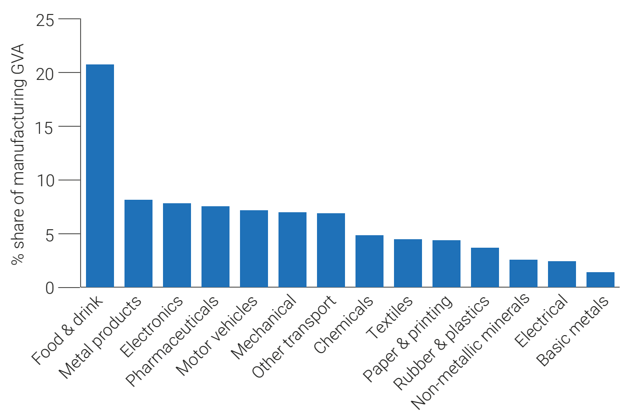
	GDP			INFLATION		
	2023	2024	2025	2023	2024	2025
US	2.5	2.3	1.4	4.1	2.5	2.1
Eurozone	0.5	0.6	1.8	1.9	1.3	1.6
France	0.9	0.5	2.1	4.9	2.3	1.2
Germany	-0.2	-0.1	1.4	5.9	1.3	0.6
Japan	2.0	0.6	0.8	3.3	1.8	0.8
China	5.2	4.4	4	0.2	0.7	1.6
India	7	5.8	6.8	5.7	4.6	4.5
World (US$ weighted)	2.7	2.4	2.6	6.0	4.1	3.2

Source: Oxford Economics

SECTOR FORECASTING 24Q1

Q1 2024 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: Oxford Economics

FOOD & DRINK

The **Food & Drink** subsector is the largest manufacturing subsector in the UK, accounting for 20.7% of all manufacturing Gross Value Added (GVA) in the latest data, an increase of approximately 2% from last quarter's data. The subsector's output forecast stands at a modest 0.3% growth for 2024, which is a slight uplift of 0.1% from the previous round of forecasting. 2025 expectations are also fairly flat, with a similar 0.3% growth forecast. Employment is expected to decline in the subsector a little faster than the industry average, with a fall of -2.9% expected in 2024 and a further drop of -1.9% in 2025.

ELECTRONICS

The **Electronics** subsector retains its negative forecast for 2024 output from last quarter's round, with a fall in output of -0.3% expected this year, a 0.2% positive revision from the previous quarter. These pedestrian forecasts for the coming years are offset by relatively strong growth in 2023 by 4.9%, which was approximately five times as strong as the sector average. However, growth is expected to emerge in 2025, with a slow return to growth of 1.5% expected in a year's time. Employment in the Electronics subsector is anticipated to decline in line with the manufacturing average, by -2.2% in 2024 and by -1.2% in 2025.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector is forecast to lose a lot of its output growth that it gained in 2023. The latest 2024 forecast for output growth for the subsector stands at -3.8%, which is considerably more negative than the manufacturing average. Its 2025 forecast is also negative, but to a lesser degree at -2.2%. Having seen a sizeable contraction in employment in 2023 (-8.5%), employment is expected to continue to decline in 2024, by -4.5% and by -3% in 2025.

The **Fabricated Metals** subsector saw its performance disassociate with the basic metals subsector approximately two years ago, having often been linked in their prospects. The subsector has a positive expectation for output growth in 2024, with a 3.3% increase in output expected in 2024. This slows somewhat, but remains positive, with further growth of 0.9% forecast for 2025. Employment, having been the largest growing subsector in this regard in 2023 (8.1%), is forecast to fall by -1.1% in 2024 and by -0.4% in 2025.

MECHANICAL EQUIPMENT

The forecast for the **Mechanical Equipment** subsector is negative in the short term but overall has a stronger upside in the longer term. Having contracted by -2.1% in 2023, the latest forecasts suggest that the sector will decline further by -1.5% in 2024, but return to growth in 2025, with an output increase of 2.5% expected then. Employment is set to contract across both upcoming years, but more intensively in the first. 2024 expects to see the subsector's total employment decline by -3.6%, and by -2% in 2025.

TEXTILES

The **Textiles** Subsector saw a -5.5% decline in its output in 2023. While the forecast for the coming year remains negative, it does so at a slower pace. The subsector is expected to see a decline in output by -2.2% in 2024, and a further decline of -3.6% in 2025. Employment will contract as well. Having been the subsector with the largest contraction in overall employment in 2023 (-10.6%) the trend looks set to continue, with a decline of -4.8% in headcount forecast for 2024 and -4% in 2025.

PAPER & PRINTING

The **Paper & Printing** subsector saw a moderate decline in output in 2023 (-5%), although now growth is expected. The latest forecast for the subsector shows that growth of 1.8% is expected in 2024 and a very modest decline of -0.3% is forecast in 2025. Employment, on the other hand, will see consistent declines across 2024 and 2025, having also contracted in 2023. The 2024 headcount for this subsector is expected to contract by -5%, and then by -4% in 2025.

ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector posted moderate growth (3.2%) in 2023 which exceeded the sector average threefold. The subsector's prospects look set to continue strong, with a further growth in output for 2024 by 4.4% forecast. However, 2025 will likely see the end of this growth trajectory, with a flat forecast of -0.4% growth in 2025 expected. Employment will remain roundly flat over the coming two years, just as had been the case in 2023 as well. Employment is expected to grow by 0.3% in 2024 and 0.4% in 2025.

NON-METALLIC MINERALS

The **Non-metallic Minerals** subsector is best known for manufacturers that primarily supply the construction market with bricks, mortar, glass and other such materials. As such, its performance is closely linked with the UK's construction market. Having held one of the more negative output forecasts for 2023, this trend looks set to continue as the subsector currently holds the most negative output forecast out of all manufacturing subsectors for output in 2024, at -7.5%. 2025 is forecast to bring back some recovery for the subsector's output, with growth of 2.7% forecast in a year's time. Employment will also fall in 2024, by -1.9% and then stabilise in 2025 with only a decline in headcount of -0.2% expected.

PHARMACEUTICALS

The **Pharmaceuticals** subsector continues to surpass expectations with how long it can maintain a growth trajectory following the subsector's boom during the pandemic. Growth was delivered in 2023 (8%) and while the rate is declining, the subsector has not entered into negative output territory for some time. The 2024 output forecast for the Pharmaceuticals subsector is 2.1%, falling to 1.1% in 2025. Employment, conversely, is expected to fall. 2024 is expected to see a decline in headcount by -1.9%, with 2025 seeing a further decline of -1.1%.

CHEMICALS

The **Chemicals** subsector, having historically been close in performance with Pharmaceuticals, fares worse in the short term but better in the long term. Output growth for 2024 is forecast to be a modest 0.2%, but 2025 sees that grow with a 3.5% increase in output expected. Employment will decline across both years, with a drop in headcount of -1.9% in 2024 and -0.5% in 2025.

RUBBER & PLASTICS

The **Rubber & Plastics** subsector held the most negative change in output of 2023, seeing a decline of -9.3%. Prospects for 2024 remain negative, but less severely so, with a decline of -4.8% forecast. This declining trajectory comes to an end in 2025, where a flat forecast is expected, with growth of 0.3%. Employment will decline, but only moderately. A reduction in headcount for the subsector by -0.6% is forecast in 2024, and by -0.4% in 2025.

MOTOR VEHICLES (AUTOMOTIVE)

Having delivered the strongest output growth in 2023 out of all manufacturing subsectors, the **Motor Vehicles** subsector has now cooled back to more 'normal' forecasting after now seeming to have completed its post-pandemic output catch-up. The current forecasts for the subsector expect output to grow by 1.1% in 2024, but decline by -1.2% in 2025. Employment is forecast to decline across both years and by similar measures, with a -3.4% decline forecast in 2024 and a further -3.1% in 2025.

OTHER TRANSPORT

The **Other Transport** subsector which is comprised of aerospace, defence, shipping and rail industries, saw robust output growth in 2023, at approximately six times the average rate of the sector's wider growth at 6.7%. The forecast for future output growth remains robust but less expansionary, with growth of 4.3% expected in 2024 and 3.4% in 2025. Employment is set to remain consistently flat in the coming years, with a slight decline of -0.3% forecast in 2024 and -0.5% in 2025.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2023	2024	2025	2023	2024	2025
Basic metals	3.1	-3.8	-2.2	-8.5	-4.5	-3.0
Metal products	3.9	3.3	0.9	8.1	-1.1	-0.4
Mechanical	-2.1	-1.5	2.5	-1.2	-3.6	-2.0
Electronics	4.9	-0.3	1.5	2.6	-2.2	-1.2
Electrical	3.2	4.4	-0.4	-0.1	0.3	0.4
Motor vehicles	14.9	1.1	-1.2	0.6	-3.4	-3.1
Other transport	6.7	4.3	3.4	4.0	-0.3	-0.5
Food & drink	-0.5	0.3	0.3	-1.7	-2.9	-1.9
Chemicals	-8.5	0.2	3.5	-6.7	-1.9	-0.5
Pharmaceuticals	8.0	2.1	1.1	2.9	-1.9	-1.1
Rubber and plastics	-9.3	-4.8	0.3	-4.8	-0.6	-0.4
Non-metallic minerals	-7.8	-7.5	2.7	-2.5	-1.9	-0.2
Paper and printing	-5.0	1.8	-0.3	-3.1	-5.0	-4.0
Textiles	-5.5	-2.2	-3.6	-10.6	-4.8	-4.0
Manufacturing	**1.0**	**0.1**	**0.8**	**-0.9**	**-2.3**	**-1.4**

Source: Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

WHAT DO THE R&D REFORMS MEAN FOR MANUFACTURERS?

UK manufacturers have entered 2024 with some stability and our survey shows some improvements in investment and employment. However, output has taken a stumble. With continuing increases in input prices, profits margins are falling, and cash flow continues to be a challenge.

Tax incentives can help boost cash flow and manufacturers should consider conducting a detailed review of their R&D claims and project plans to help reduce current tax liabilities and help fund future innovation and investment. For example, re-evaluating expenditure in prior years, manufacturers could identify tax relief that has not yet be claimed.

INCREASED FOCUS ON R&D CLAIMS

For the last 12-18 months, the world of R&D incentives has been quite turbulent. Last year, HMRC published R&D claims statistics estimating the level of error and fraud at around £1.13bn. This further highlighted the importance of a review of the R&D regime.

HMRC's initial consultation resulted in an initial wave of reforms from April 2023 including:

- Changes in the RDEC and SME scheme rates resulting in a significant reduction in the difference between the two regimes and a clear step towards a merged scheme
- Introduction of the R&D Intensive Scheme for loss making SMEs
- Introduction of new expenditure categories including Data and Cloud Hosting costs, as well as the inclusion of Pure Maths
- Submission of a claim notification if companies are claiming for the first time, or if the last claim was more than three years.

We also saw the introduction of the Additional Information Form (AIF) for all submissions from 8 August 2023 and a step change in compliance checks – HMRC latest announcement was that it now reviews 20% of all R&D claims.

FURTHER CHANGES ON THE HORIZON

In the 2023 Autumn Statement, the Treasury finally confirmed that the merged R&D scheme would be introduced for accounting periods starting on or after 1 April 2024. The aim is to make the claim process simpler. The merged scheme will be:

- Based on the existing RDEC scheme i.e. an above the line credit at a gross rate of 20% and subject to tax with the RDEC style seven-step calculation
- Loss making companies will be subject to the 19% CT rate versus 25% for tax paying companies
- All companies will be able to claim on qualifying projects that received a grant or subsidy
- All companies can now claim for contracted out activities (in the right circumstances)
- Overseas costs will need to be excluded – unless they meet certain exemptions.

Additionally, the R&D intensive scheme for loss making SMEs continues, but the required R&D intensity threshold will be lowered to 30% for accounting periods starting on or after 1 April 2024, meaning more companies will be eligible.

Whilst HMRC's intent is to make the R&D process simpler, with all these changes coming in at different times, manufacturers will need to consider expenditure on R&D activities carefully or they risk losing the financial benefits the current R&D schemes can offer. More importantly, with increased scrutiny from HMRC (there will be more inspectors and the more prescriptive submission process), the transition period is likely to be challenging. Read more here: https://www.bdo.co.uk/en-gb/insights/tax/innovation-and-research-and-development-tax-incentives/research-development-r-d-tax-relief-changes-how-they-work-in-practice.

The Chancellor has also just announced a significant funding package for R&D and manufacturing projects across the life sciences, automotive and aerospace sectors, which is welcome news for the manufacturing sector. Read more here: https://www.gov.uk/government/news/360-million-to-boost-british-manufacturing-and-rd.

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

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

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

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

MakeUK.org

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The data used in this survey have been provided by UK manufacturers including members of Scottish Engineering, Manufacturing NI, and Make UK. Contributing to our surveys helps to accurately reflect trends and behaviours that shape the UK manufacturing sector. If you would like to participate in future surveys, please contact our Information and Research team research@Makeuk.org

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We provide real solutions to industry issues, utilising our capabilities in everything from sector-specific accountancy, tax and business advice to patent box and research and development claims and M&A opportunities to help our clients grow in the UK and overseas. We also provide manufacturing businesses and organisations with robust, independent audits.

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: advanced manufacturing, aerospace, automotive, building products, chemicals and pharmaceuticals, food and drink, electronics, industrials, test and measurement and technology.

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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The Manufacturers' Organisation

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