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MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2022 QUARTER 2

With support from:

Scottish Engineering
and Manufacturing NI

FOREWORD

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This year marks the Platinum Jubilee of HM Queen Elizabeth II. 1952, the year Her Majesty ascended to the throne, was an important year for the British economy. Much post-WWII rationing came to an end as the cost of living started to improve. But the country also faced significant challenges as the Commonwealth Prime Ministers' Economic Conference met to discuss the instability of the British Pound, and a worrying decline in British exports, as a result of which the British government attempted to renegotiate our terms of trade with the rest of the world.

70 years have since passed but many of those same themes have recently re-emerged.

The latest BDO/Make UK *Manufacturing Outlook* survey finds that the volume of British exports are once again in decline. Overseas orders for British made goods appear to have reached a post-Brexit and post-pandemic plateau. Strong order books fuelled the manufacturing industry through the turbulent past few years but a worrying demand slump now poses a significant recession risk to the sector.

Domestic orders continue to hold but UK market prices remain extremely high. For manufacturers, higher prices risk becoming the new normal if input costs, including for wages, food, and fuel; keep spiralling upwards.

At the same time, our survey finds that profit margins continue to shrink, squeezing companies' cash reserves. UK inflation is already at its highest on record. The usual remedy is to raise interest rates to make it more expensive for consumers and businesses to borrow. This means they spend less, helping cool demand and, in turn, slow the pace of inflation. However, the current rise is driven primarily by external factors, including the war in Ukraine, meaning domestic interest rate hikes will have little effect. All the while insolvency firms are seeing growing numbers of British businesses at risk of going bust as costs spiral and COVID loan repayments come due.

The Office for National Statistics revealed last month that the UK economy shrank by 0.1% in March. That decline may be followed by a bigger one in April after the National Insurance hike and myriad other increases including energy, VAT, council tax, and broadband bills kicked in.

The services sector was the main contributor to the contraction but the worst performing subsector was in manufacturing, with the motor industry struggling as sales fell and supply chain problems resulting from the knock-on effects of ongoing COVID-19 lockdowns in some of China's major shipping hubs, hamper production.

Rising prices are already making the UK government's 'Levelling-up' plans to reduce regional inequalities more difficult and yet more important. Manufacturing firms are often the bedrock of the 'left behind' regions of our economy. Their success is imperative if the escalating cost of living crisis is to be tackled. But as it stands, employee recruitment has slowed and investment intentions are in retreat because business confidence is down.

Instead businesses are now facing the highest tax burden since the Queen's coronation 70 years ago, with corporation tax, and national insurance contributions also set to rise again next April. Chancellor Rishi Sunak advised firms recently that the economy faces a "perfect storm". That warning is clear. Ministers must do whatever it takes to support businesses and protect jobs if our economy is to avoid another *annus horribilis*.

HEADLINES

Make UK's Q2 2022 *Manufacturing Outlook* report, in partnership with BDO, shows manufacturers continue to see activity slow down and prices rise at record rates.

For the third quarter in a row the growth of output and orders slowed down as the post-pandemic boom continues to dissipate. Rising prices are now beginning to put off international customers from UK goods.

However, that is not the case for all manufacturers. Many continue to report an influx of new work, particularly those that operate within the aerospace supply-chain. Therefore, the latest results today represent a highly mixed picture, but risks are weighed towards the downsides because of inflationary challenges. For those businesses that have robust orders books, it is the "access of" rather than cost of materials that are posing the biggest threats to their business.

The balance score for employment and investment intentions significantly dipped this quarter but remain positive. Employers have struggled to fill roles over the last few months, particularly for skilled workers in the sector. Vacancies are at an all-time high in part because the labour force has shrunk since 2020. Investment plans are either being pushed back or cancelled entirely as the weight of recent trade disruptions takes a toll on cash-flow positions.

Since the start of this year, inflation has shown hardly any sign of slowing down and manufacturers now face the biggest cost increases in energy, raw materials, and labour, in decades, on top of the highest tax burden in 70 years. Because of this, margins have tumbled this quarter as businesses struggle to find efficiency gains and higher prices turn off some customers. For the moment, robust demand is keeping industry going but there are fears that this may be coming to an end.

INDICATOR	BALANCE	CHANGE	
Confidence	6.4	↓	Businesses remain slightly optimistic
Output	10%	↓	Production falls again
UK orders	16%	↓	Domestic market remains dominant but is losing momentum fast
Export orders	4%	↓	Exports report recurring declines
Employment	9%	↓	Jobs no longer improving but expectations are high
Investment	5%	↓	Business continue to backtrack on investment plans

Source: Make UK Manufacturing Outlook Survey

The latest quarter's research is in sharp contrast to the expectations set by manufacturers in the first quarter of this year. Many businesses revealed expectations for faster growth in output, orders and employment for Q2 2022, but these predictions did not come to pass. This difference between forecasts and reality highlights the severity of economic shocks that have taken place in the last three months, including mainly the Russia-Ukraine conflict, new COVID-19 lockdowns in China, and rapidly rising inflation.

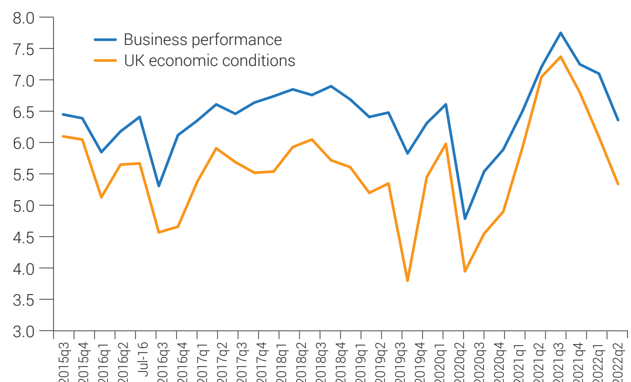
Nevertheless, the balance for output is at 10% this quarter indicating that overall, a greater share of manufacturers reported higher output volumes than those that reported lower output volumes. However, that share's balance has more than halved from last quarter's 24% indicating the rate of deceleration is increasing. Moreover, the gap between output and orders remains wide, with the balance of total orders reporting at 20% this quarter. Despite this gap, strong order books are one of the key factors contributing to the growth of the sector, which forecasts to expand by the end of the year.

Our UK and export order metrics have reported positive balances this quarter, at 16% and 4% respectively. In line with the other metrics in the survey, both have reported a slow-down in growth, with exports falling remarkably close to a zero balance. Manufacturers continue to face challenges because of the UK's exit from the European Union, but rising prices will have likely had an additional impact on the willingness of foreign customers to buy from UK manufacturers.

Both business and economic confidence have fallen for the third quarter in a row following their peaks in Q3 2021. However, confidence remains above 5 meaning on average more manufacturers are positive than they are negative about the next 12 months.

Confidence continues to dip but overall optimism remains high

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

The pace at which the outlook has evolved over the last three months is laid bare in the difference between manufacturers' projected production volumes in the first quarter of the year, and how much output has been realised by this checkpoint in the second quarter of the year. The balance figure for Output now stands at +10% this quarter.

Only three months ago, manufacturers indicated that they expected the industry to post a balance figure for output of +44%. In hindsight, this figure seems exceptionally optimistic. While production-limiting pressures had been mounting for manufacturers over the past few quarters, they had not been severe enough to significantly curtail quarterly Output performance, until now.

While both Output and Orders have seen a worsened performance this quarter, the output gap that emerged in the third quarter of 2021 has remained. This gap, the excess of orders (demand) over output (supply), has been a signal over the past three quarters that the industry is struggling to keep up with the demand for its product. This gap also drives inflationary pressures both within the industry and for the end-user.

Price of, and access to, material inputs continue to be the leading limiter of manufacturers' ability to grow output to meet demand. While this challenge was the same key factor that was limiting output last quarter, the challenge has escalated in the intervening months. Producer Price Inflation, which tracks the average change of costs of inputs for the production sector, stands at 18.6% on the year to April, the highest since ONS records began.

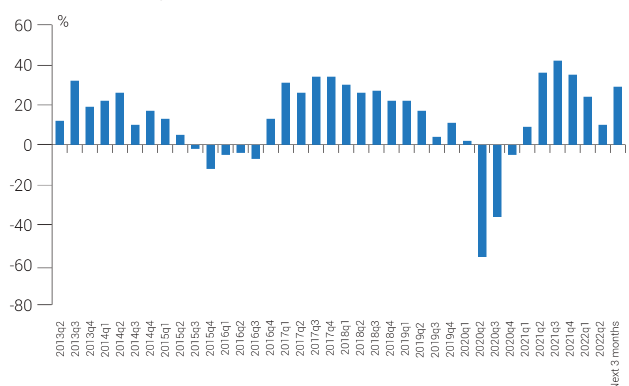
Given the disappointing output performance compared to industry expectations, it would be understandable to treat manufacturers' latest expectations, an expected +29% balance figure for the third quarter of the year, with doubt. There is currently little indication that the headwinds limiting Output growth are about to pass. Further, it is not but one challenge that needs to pass to unshackle the industry's output performance: material prices, material access, labour access, labour prices and logistics disruption, in that approximate order, are all currently weighing on the sector's prosperity.

As the industry enters a more distressed position relative to previous quarters, we can observe a phenomenon that revealed itself during the pandemic's performance suppression period, that smaller companies, as defined by their turnover, are suffering from worsened Output performance compared to their larger counterparts. For example, the latest balance figures show that for this second quarter, the £25m+ turnover band of companies showed Output performance that was just under twice as strong as those companies in the smallest turnover bracket of £0-£9m. While this may not be immediately surprising, as larger companies are likely to have greater short-term resilience to these production headwinds, it's important to remember that the large majority of the UK's manufacturing base comprises of SMEs, and so SME manufacturing performance directly affects a greater proportion of the UK's jobs and communities than the former.

PAST THREE MONTHS		NEXT THREE MONTHS	
↓	10%	↑	29%

Output growth retreats significantly as headwinds limit production

% 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%	25%
Metal Products	17%	22%
Mechanical	20%	26%
Electronics	23%	54%
Electrical	0%	27%
Rubber & Plastics	50%	50%
TURNOVER		
£0-9m	18%	28%
£10-24m	21%	36%
£25m and over	31%	26%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The balance for total orders for the latest quarter's research indicates a much sharper slow-down in the growth rate of new work. The latest balance of 20% is less than half the level from last quarter (42%) suggesting the demand boom may finally be ending. However, as the balance score is still positive it means more manufacturers across the sample are still reporting increasing orders than those that are reporting decreasing orders.

The gap between the balance for output and orders has also shortened in absolute terms which may be a sign of supply-chain challenges easing. However, total orders remain twice the size of output levels, indicating substantial delivery challenges persist. Indeed, Make UK members have consistently highlighted the difficulties they face in accessing components and raw materials which is making it more difficult to deliver on customer orders.

UK ORDERS	PAST THREE MONTHS	↓	16%	NEXT THREE MONTHS	↑	22%
EXPORT ORDERS	PAST THREE MONTHS	↓	4%	NEXT THREE MONTHS	↑	11%
TOTAL ORDERS	PAST THREE MONTHS	↓	20%	NEXT THREE MONTHS	↑	28%

Despite the downward trajectory of the last three quarters, manufacturers still expect faster growth in the future. This was also predicted in the Q1 *Manufacturing Outlook* survey but did not come to pass as in the last three months the industry faced a plethora of new challenges, from the Russia-Ukraine conflict impacting access to certain metals to COVID-19 lockdowns in China blocking access to freight and critical electronics.

Given how quickly the economic environment changed between Q1 and Q2 it is more challenging to accept business's own predictions of the next quarter as accurate. Uncertainty has impacted manufacturers since mid-2016 and it seems probable that there will be further unexpected events to come, so manufacturers will have to remain agile.

UK ORDERS

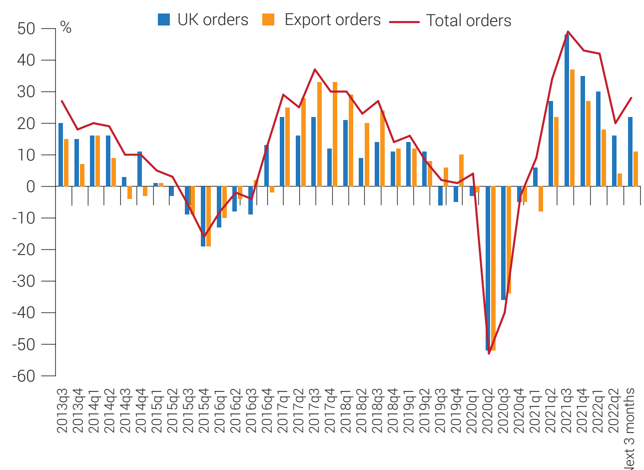
UK orders continue to outperform export orders, reporting a balance of 16% for this quarter. However, the rate of growth for the domestic market has approximately halved between the first and second quarters of this year, evidence of the significant impact recent events including supply-chain issues have had on the UK markets. That being said, a positive balance of 16% still indicates growth at a level that far outweighs the growth seen in the export market (4% on balance).

This marks the seventh quarter in a row the domestic market has technically expanded in terms of orders, despite the obvious slow-down in the rate of growth. However, as industry continues to slow and businesses face increasing costs the risk of a decline in the domestic market grows also.

The latest results for intermediate subsectors shows positive balances for all industries across the board, except for both Basic Metals and Electrical Equipment, which reported flat balances of 0%. However, in line with the theme of slowing growth, all intermediate subsectors (excluding Electronics) saw a fall in the balance of change in UK orders when compared to last quarter.

New orders growth continues to slow, but domestic market remains dominant

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

Most of these subsectors forecast faster growth for Q3 this year. The few that expect a further slow-down include Mechanical equipment and Rubber & Plastics. The latter rely on consistent demand from the construction sector, which has recently been reporting slowdowns in orders themselves.

EXPORT ORDERS

Export orders reported a balance of 4%, a significant slow-down since last quarter.

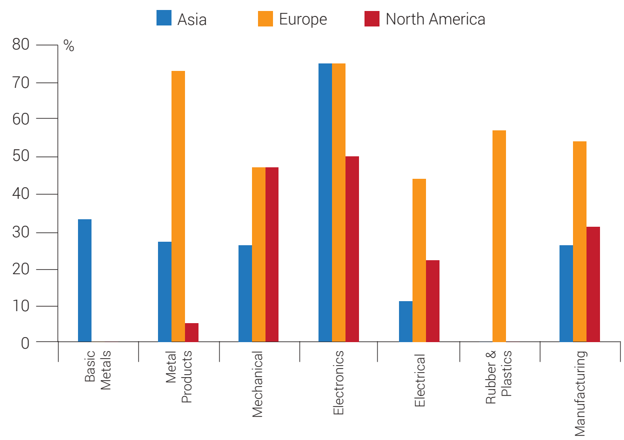
The sharp slowdown in new export orders is not surprising given most recent shocks to supply have been both external and international. The two main changes being the Russia-Ukraine conflict and the resurgence of COVID-19 infections in China. In addition, the UK continues to face unique export challenges brought on by the change in the trading relationship between the UK and EU. From the perspective of EU manufacturing, this change has made the UK a less attractive market to buy goods from.

The concern for manufactures now is whether tensions over the implementation of the Northern Ireland Protocol will lead to the UK triggering Article 16, resulting in trade tensions with the EU, our biggest trade partner, possible sanctions from the United States, and the risk of a return to a no-deal Brexit. Regardless of the outcome, the mere threat of this change is already impacting how foreign businesses perceive the UK markets today and their willingness to do business with UK firms.

Manufacturers continue to report positive demand conditions from the rest of Europe. The share of 54% of manufacturers is unchanged from last quarter. Both North America and Asia remain critical sources of demand for UK manufacturers, but the latter has been very challenging to trade within the last few months as lockdowns in Shanghai have led to port closures.

Demand conditions in Europe remains robust but weakens slightly

% 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%	10%	0%	18%	8%
Metal Products	3%	11%	0%	-3%	14%	11%
Mechanical	27%	18%	14%	16%	27%	24%
Electronics	25%	42%	30%	50%	31%	46%
Electrical	0%	50%	-21%	-7%	13%	60%
Rubber & Plastics	63%	38%	29%	14%	63%	63%
TURNOVER						
£0-9m	19%	18%	3%	3%	27%	24%
£10-24m	32%	12%	19%	15%	29%	31%
£25m and over	30%	35%	13%	18%	27%	27%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

Though remaining positive, our Employment and Investment intentions metrics both show significantly worsened performance when compared to last quarter. Both show only single-digit positive balance figures in this report.

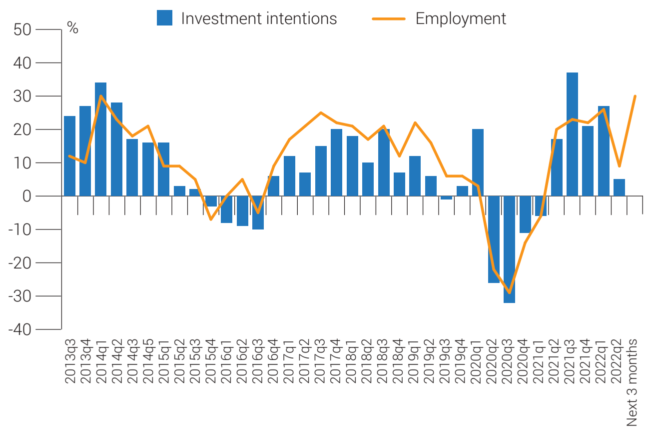
Over the past four quarters, demand for labour exceeded supply, but employment growth was showing relatively strong balance figures in that time. This quarter, our data shows that the recruitment rate has significantly slowed. For context, in the past three quarters, the average balance figure for employment was +24%, but the latest figure now stands at only +9%.

Most importantly, this slump in employment growth is not for a lack of demand from the UK manufacturing industry. Quite the opposite, demand for labour in the sector is at a record high, as measured by vacancies data. Make UK's own future employment intentions metric also indicates as much, with a positive balance of 30% of the industry suggesting that they will endeavour to expand their labour force in the next three months. Despite the desire for extra staff, this level of employment growth is unlikely to come to pass as the industry will continue to struggle to find workers in an extremely tight and shrinking labour market.

drop following a few quarters of notable improvement. The balance figure of investment intentions, now standing at +5%, has dropped from the +27% seen last quarter. The drop in investment intentions follows the wider slowdown in the industry's other metrics, such as those seen in order and output, and reflects a loss of confidence in the sector's prosperity in the short term.

Employment and investment intentions growth accelerates

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↓ 9%	NEXT THREE MONTHS	↑ 30%
INVESTMENT	NEXT TWELVE MONTHS	↓ 5%		

The latest ONS data[1] shows that vacancies in the manufacturing industry are at an, at least, 20 year high – this is how far back the time series runs. The current rate of vacancies in the industry stands at 4.1 roles per 100 employed. By way of comparison, the average figure across that same twenty-year time period is only 1.9. For an even more poignant comparison, we can look to the Retail sector's vacancy rate, which stands at a less severe 3.6 vacancies per 100 employed. Bearing in mind that the Retail sector will typically have a significantly greater proportion of low-skilled, part-time, and short-term jobs, with a comparatively high turnover rate, the fact that the vacancy rate is higher in the manufacturing sector illustrates the severity of the labour shortage the industry is grappling with.

The outlook for investment intentions this quarter is, unfortunately, similar to that of employment, a significant

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	0%	17%	0%
Metal Products	11%	19%	9%
Mechanical	9%	30%	3%
Electronics	15%	69%	42%
Electrical	-7%	40%	7%
Rubber & Plastics	13%	0%	0%
TURNOVER			
£0-9m	21%	28%	12%
£10-24m	17%	16%	17%
£25m and over	8%	34%	12%

Source: Make UK Manufacturing Outlook Survey

1 ONS Vacancies by Industry data, Published 14th May 2022, accessed 8th June 2022

PRICES & MARGINS

The rising cost of doing business is hitting manufacturers harder than ever before. Not for the first time in the last few years firms are having to make difficult choices as to whether to continue operations or shut processes down to save on energy and other costs. Insolvency firms are seeing a growing number of UK businesses at risk of going under as costs spiral and Covid loan repayments come due. Fortunately, demand remains high, but access to inputs has made delivering on those orders more challenging.

From rising energy bills, to logistics, wages, raw material costs, and the highest tax burden in 70 years, UK manufacturers have seen it all these last few months. Our latest research shows prices have continued to expand at record rates for almost five quarters a row.

UK price growth has shown some marginal slowdown reporting a balance of 54% (down from 58%) but it is still the second highest balance on our survey's 30-year history. Export prices continue to speed ahead reporting a balance of 52% (up from 50%). The acceleration of rising export prices likely also played a role in the declining of export orders, which saw a more severe slowdown in growth than domestic orders this quarter.

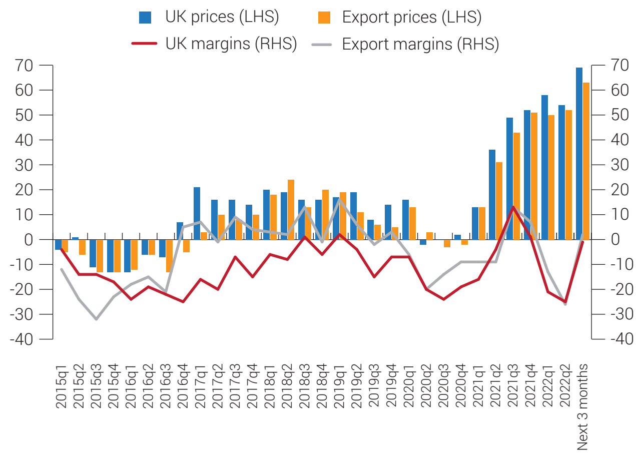
According to the Office of National Statistics (ONS) input inflation is at 18.6%, the highest in the survey's history, whilst output inflation is rising at a relatively slower rate of 14%, the highest since 2008. Unsurprisingly, UK manufacturers are reporting continued declines in margins as the cost of doing business rises to unsustainable levels and raises the risk of higher insolvencies if businesses end up defaulting on debts.

The contraction in margins is also in contrast to expectations that were made in the first quarter of this year when manufacturers initially expected recovery in profits. However, the severity of novel economic shocks was so great that business expectations were turned up-side down. Now manufacturers expect further negative growth in UK margins for the next quarter, albeit to a lesser degree. However, export margins are expected to improve for a small majority of the industry.

Next quarter, manufacturers expect prices to grow for an even larger balance of businesses.

Prices continue to grow at pace but margins fail to improve

% balance of change

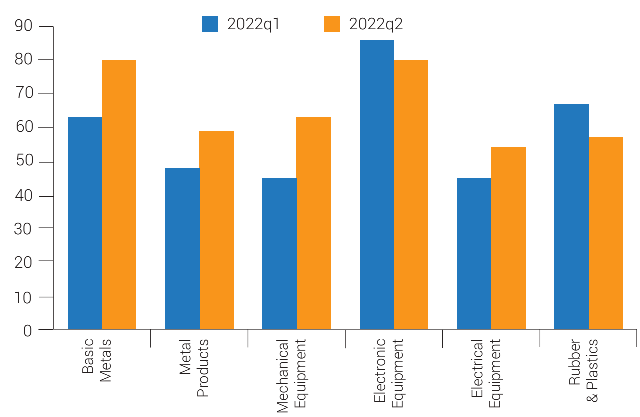


Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↓	54%	NEXT THREE MONTHS	↑	69%
EXPORT PRICES	PAST THREE MONTHS	↑	52%	NEXT THREE MONTHS	↑	63%
UK MARGINS	PAST THREE MONTHS	↓	-25%	NEXT THREE MONTHS	↑	-1%
EXPORT MARGINS	PAST THREE MONTHS	↓	-26%	NEXT THREE MONTHS	↑	2%

Export prices of materials growing for all intermediate subsectors

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

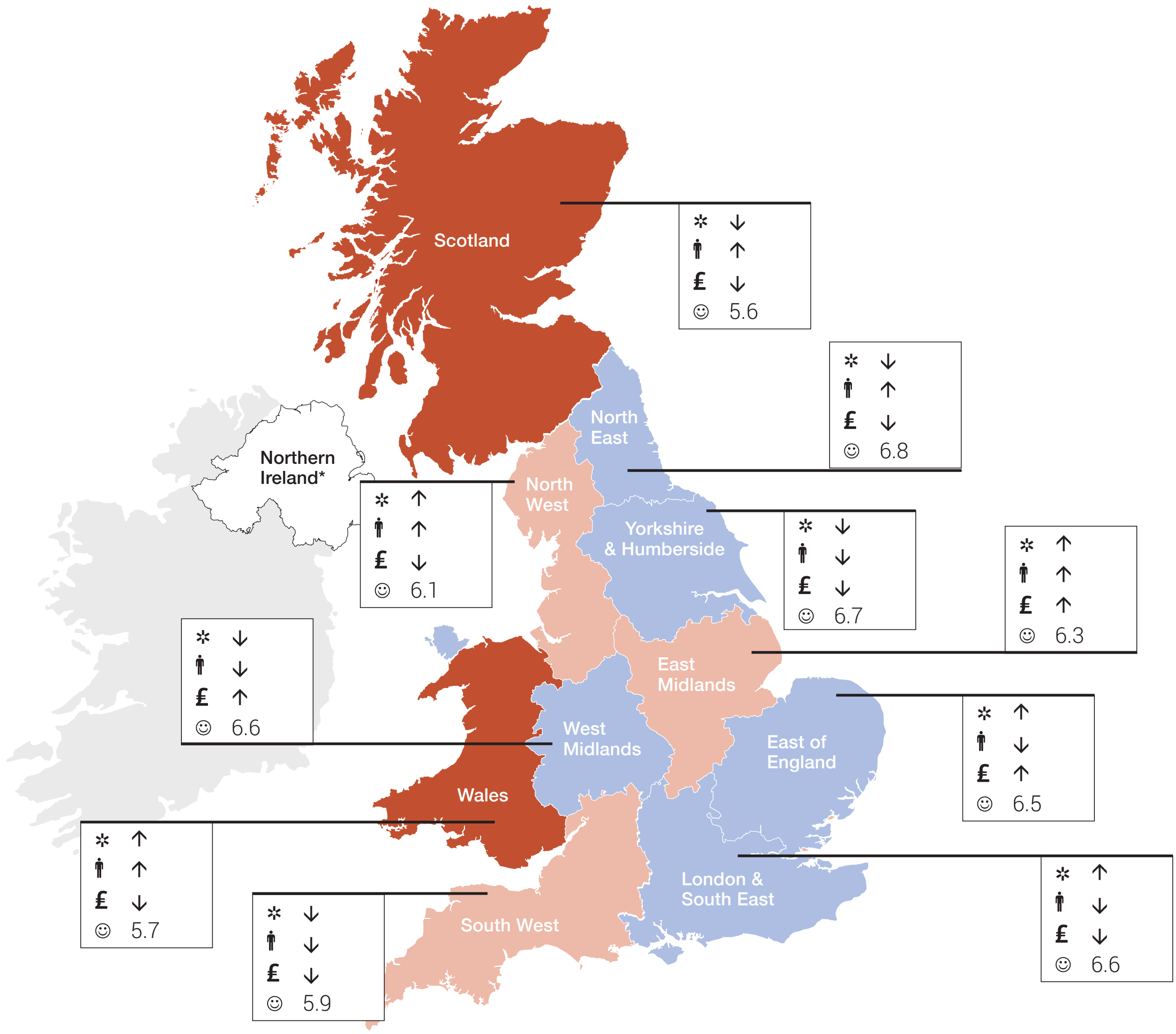


Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

This quarter's *Manufacturing Outlook* report finds that firms' confidence in business conditions remains optimistic overall despite ongoing challenges. However, confidence in the domestic economy has turned more negative this quarter for certain parts of the UK (below the '5' inflexion point).

Unsurprisingly, most areas of the UK have reported a continuation of the downward trend in optimism seen over the last few quarters. It is apparent that both ongoing and novel challenges are beginning to bite manufacturers' operations which is making it increasingly difficult to stay positive about the next 12 months.



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER

✲ OUTPUT

EMPLOYMENT

£ INVESTMENT

☺ BUSINESS CONFIDENCE

* INSUFFICIENT NI DATA FOR CALCULATION IN THIS INSTANCE

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

Still, confidence is a volatile metric and can change dramatically depending on the day-to-day performance of a business, as well as the news surrounding the UK economy and politics. It does not necessarily always correlate with future performance. However, as was the case in the last few quarters, the declines seen in confidence are mirroring the declines being reported for output and orders too.

The biggest issues that have impacted confidence levels recently include the cost-of-living crisis and the escalating cost of doing business. Manufacturers are facing rising costs for raw materials, labour, energy, and freight transport, as well as the highest tax burden in 70 years. Coupled with these costs is the growing difficulties firms face in accessing raw materials, labour, and freight transport, even when they are willing to pay higher prices.

In line with the national average, all regions and devolved nations reported a fall in business confidence compared to last quarter. However, all regions and nations remain within positive territory[2].

Headline business confidence reported at 6.4, a decline of 0.7 from Q1 2022. This is the largest negative change in business confidence this year. However, 6.4 is still relatively high and suggests businesses feel more optimistic than pessimistic.

Nevertheless, these expectations are continuously being tempered downwards and are likely to trend below 5 eventually if current challenges worsen. For now, as demand in the sector remains strong businesses still have a lot of work to deliver on and this is allowing them to create more value across industry.

For the first time this year, this average decline in business confidence is a result of a drop across all regions and nations between the first two quarters of this year. Manufacturers in the South West reported the biggest fall in confidence, declining by 1.1 points to 5.9. Across the UK, four regions reported a decline of 1 point or more. The remaining three include the North East, South East & London, and Scotland.

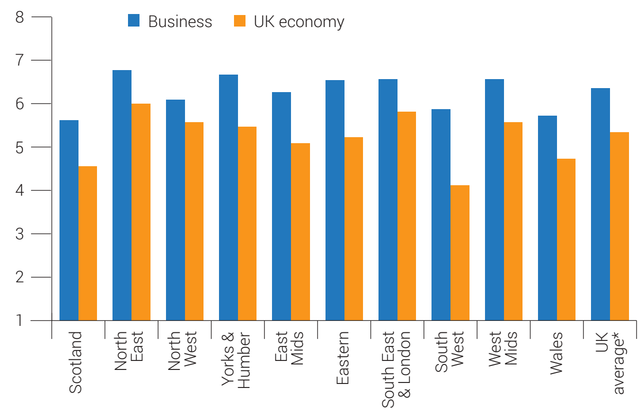
This quarter, however, the North East remains the most confident region in the UK for business conditions. Despite declines across the board, five regions have reported confidence levels that are above the UK average (6.4) for this quarter.

UK ECONOMY CONFIDENCE

Manufacturers' views of the overall UK economic condition came in at 5.3, just above the inflexion point for negative expectations. Manufacturer's views on economic conditions have deteriorated consecutively over the last few quarters, with suggestions of possible incoming recession likely placing downward pressure on those expectations. Fortunately, manufacturers just about remain positive about the economic future of the UK.

Business confidence positive for all regions and nations

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.

2 This includes Scotland which follows a different survey elicitation method, which means Scottish confidence values should be compared with other Scottish confidence values only.

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	15	35	22	28	24	36
North East	33	22	33	11	44	33
North West	39	4	9	22	-9	5
Yorks & Humber	0	47	27	27	-7	27
East Mids	19	33	27	50	18	32
Eastern	38	54	62	62	23	15
South East & London	29	21	25	14	7	32
South West	12	29	6	29	6	41
West Mids	13	26	26	35	4	17
Wales	18	45	55	18	18	9
Northern Ireland*	–	–	–	–	–	–

* Insufficient NI data for calculation in this instance

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

Chancellor Rishi Sunak recently warned the economy faces a “perfect storm”. At 9%, UK inflation has not been this high since the Consumer Prices Index was invented in 1982. The older Retail Prices Index measure is even higher, at 11%.

About four-fifths of the current rise in inflation is driven by global energy and food prices, meaning domestic interest rate hikes will have little effect. The Bank of England (BoE)’s Governor Andrew Bailey has warned the UK could therefore be on the brink of recession.

The poorest people in the UK are already experiencing a real-terms drop of £59 per month in their discretionary spending budgets as wages are failing to keep pace with inflation. The escalating cost of living crisis has prompted a ‘big state’ response from a Conservative government now overseeing the highest tax burden in 70 years.

Amidst all this the UK’s economy shrank by 0.1% in March. That decline may be followed by another in April after the National Insurance hike and myriad other increases including energy, VAT, council tax, and broadband bills kicked in.

Energy prices are also set to increase more than 50%. In April, energy regulator Ofgem lifted the price cap on gas and electricity bills adding an unprecedented £700 to the average household energy bill. The cost of filling an engine has also risen sharply for freight transport companies. At the time of writing, the cost of filling a 55-litre tank has reached £100.27 for petrol and £103.43 for diesel for the first time. That means the average cost of a litre of petrol has increased by 25% since September, and diesel by 30%. Even electric vehicle (EV) charging, which is usually half the cost per mile compared to filling a family car with petrol, has risen by 21% this year. Oil prices are expected to remain elevated into 2024 with a barrel of the benchmark measure, Brent Crude, projected to average $100 this year.

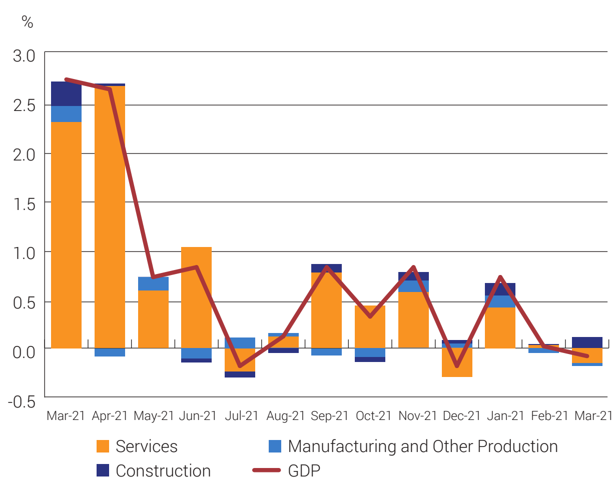
At the same time, the World Bank has warned that Russia’s invasion of Ukraine is causing a global recession as the price of food, energy, and fertiliser experience the largest commodity price shock since the oil crisis of 1973.

Before the war Russia and Ukraine accounted for 28.9% of global wheat exports, and 60% of global sunflower supplies – a key ingredient in many processed foods. As exports from Ukraine and Russia have fallen, the UN food prices index has risen to its highest since records began 60 years ago. Average UK food bills are expected to increase by at least £271 per person this year.

In addition, the war in Ukraine will “severely set back” the global economic recovery with the UK now expected to be the slowest growing G7 economy next year, the International Monetary Fund has warned. The Organisation for Economic Co-operation and Development (OECD) has predicted that the UK’s performance in 2023 will be the worst of all major economies, behind even the heavily sanctioned Russia.

UK GDP fell in March due to a decline in services

Contributions to monthly GDP, percentage points, March 2021 to March 2022



Source: ONS

The UK faces all the same challenges as everyone else, but our underperformance compared to other economies is explained, the both organisations say, by Brexit which will hold back export growth.

On a positive note, new ONS stats indicate there are more job vacancies than unemployed people in the UK for the first time since records began. However, total employment remains below its pre-pandemic level because around half a million people left the labour market owing to post-Brexit immigration barriers, older workers retiring at a higher rate during the lockdowns, and a rise in long-term illness, notably Long Covid.

The result is that the pound is expected to be the third-worst performing major currency this year. This at a time when other currencies are performing poorly anyway. The euro sank to a five-year low against the dollar, raising expectations that the world's two most traded currencies could soon reach parity for the first time since 2002. Parity is an indicator of lack of faith in the euro area economy which, despite trade falls since Brexit, remains the UK's largest export market.

Inflation, higher energy prices, labour shortages and the war in Ukraine have made firms pause investment, stopping them creating jobs and paying higher wages but just in case you thought things couldn't get any worse, new COVID-19 lockdowns in some of China's major cities – including the financial, manufacturing and shipping hub of Shanghai – are now predicted to add further to slowdowns in trade across the globe.

UK Economic Forecasts

% change except where stated

	2021	2022	2023
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.16	1.19	1.18
Exchange rate ($/£)	1.38	1.34	1.38
Exports	-0.4	6.6	4.7
Imports	3.9	8.5	4.7
Current account (% GDP)	-3.0	-4.1	-3.2
OUTPUT			
Manufacturing	6.8	2.3	1.8
GDP	7.5	3.6	1.4
COSTS AND PRICES			
Average earnings	5.8	3.3	2.7
Oil price (Brent Oil $/bl)	70.7	100	86
EMPLOYMENT			
Manufacturing (000s)	2,533	2,553	2,542
Rest of economy (000s)	34,963	35,301	35,543
Unemployment rate (%)	4.5	3.8	3.8

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

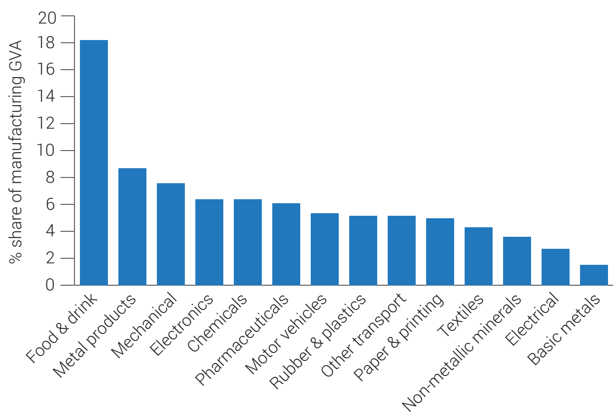
	GDP			INFLATION		
	2021	2022	2023	2021	2022	2023
US	5.7	2.5	2.0	4.7	7.4	2.7
Eurozone	5.2	2.7	2.5	2.6	18.4	8.5
France	7.0	2.8	1.8	1.6	4.5	1.6
Germany	2.8	1.8	3.1	3.1	6.0	1.3
Japan	1.6	2.1	2.3	-0.2	1.7	0.1
China	8.1	4.0	5.3	0.9	2.3	2.5
India	8.3	6.9	5.5	5.1	6.7	4.7
World (2015 PPPs)	5.9	3.0	3.1	4.3	7.3	3.5

Source: Oxford Economics

SECTOR FORECASTS

Q1 2022 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: Oxford Economics

FOOD & DRINK

The UK's largest manufacturing subsector, by just over a factor of two, accounting for 18.2% of all value generated by the wider manufacturing sector, is the **Food & Drink** subsector. Despite a fairly significant downgrade in the subsector's output forecasts last quarter, where they were slashed from projected 6.9% growth in output to 2.8%, the outlook has improved somewhat with the latest forecast now showing an expected 3.3% growth in output expected for the year. Despite the overall manufacturing output growth forecast for 2022 having declined since the first quarter's round of forecasting, the Food & Drink subsector's outlook has bucked the trend and seen improvement, albeit marginal. The employment growth forecast has also improved compared to the previous quarter, with growth of 1.9% forecast, which follows if the sector is expecting to outperform earlier forecasts for output growth. This employment growth forecast is also four times the manufacturing sector average.

ELECTRONICS

The **Electronics** subsector has also seen an improvement in its output forecast relative to last quarter. As major supply chain limitations, most infamously concerning semiconductors, begin to subside for some, or become acclimated to, the output growth forecast has been revised upwards to 3.1% for 2022. This is a notable improvement on the year's first-quarter forecast which only expected 1.2% growth. In any case, the current expected growth for the Electronics subsector now outperforms the manufacturing average. Employment, however, is expected to decline this year, with an estimated reduction in labour by -4.1%. This is well below the industry average and also the third most negative expectation out of all manufacturing subsectors.

BASIC METALS AND METAL PRODUCTS

Despite comparatively encouraging growth forecasts for the **Basic Metals** subsector, the ongoing Russia-Ukraine conflict has introduced significant volatility to the subsectors' forecasts. The medium-term impacts of the current metals shortage in both Russia and Ukraine on UK metals buyers remains uncertain.

Having closely followed the wider manufacturing industry growth expectations for the past few quarters, the Basic Metals sector has a revised output forecast that shows an improvement in output expectations compared to its subsector peers. This quarter's latest output growth figure for 2022 stands at 5.9%, the third-highest output growth forecast out of all subsectors, and just shy of three times the size of the industry growth average. Employment expectations for the year, while marginally negative at -0.2%, remain roundly flat.

The **Fabricated Metals** subsector has seen a significant improvement in its forecast for output growth for the year. Not too dissimilarly to the Basic Metals subsector, as their performance is understandably linked, the subsector is now forecast to experience output growth by 7.5% in 2022. This is a very large improvement in the outlook for the sector in this second quarter, as last quarter the output growth expectation only stood at 1.1%. Employment is expected to experience some steady growth, outpacing the manufacturing average too, at 2.2% in 2022.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector enjoyed significant output growth in 2021. This came to pass as the subsector is often the recipient of capital expenditure, and as the output gap grew in the industry, expectations were that the subsector would see a sustained boost in demand while the wider economy expanded its capacity. Due to an economy-wide slowdown, that optimism for the subsector's prospects has cooled also. The latest forecast for the subsector's output growth forecast for 2022 stands at 4.6%. While this is still double the wider manufacturing average output growth forecast, it's a far cry from the pace in output growth observed just over a quarter ago. The employment forecast expects a contraction in labour in the industry in 2022 by -4%.

TEXTILES

Having fared better than expected in terms of output growth in 2021, the **Textiles** subsector entered the year with somewhat meagre growth forecasts. Now in the second quarter, that outlook has improved, with the latest output forecast for 2022 standing at 5.6%. This is over twice the manufacturing average growth rate and is currently one of the more positive forecasts for manufacturing subsectors. As the sector is labour intensive, it follows that the employment growth forecast is also positive to deliver on this expected output, with a growth of 4.2% in the subsector's workforce expected this year.

PAPER & PRINTING

The **Paper & Printing** subsector is forecast to grow in output this year slightly below the manufacturing average, at 1.8%. This is a downgrade from the previous quarter's forecast which posted an expectation of 3.8% growth. However, the Employment forecast has improved, with a decline of only -1.5% expected in 2022, compared to the previous forecast of a -3.4% decline. Nevertheless, the subsector is forecast to endure an employment decline while the industry average expects no-to-marginal growth in employment.

ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector has received a similar forecast to what it received in the last round of forecasting. Last quarter, the subsector was predicted an effective 'no change' in the output growth figure of 0.01%. This time around, that figure is very similar at -0.1%, with an added air of negativity. In practice, this forecast is effectively a 'no change' forecast too. However, employment growth is expected to be significant for the year, at 10.2%. The explanation for this anomaly likely lies in the subsector's involvement in large, often state, infrastructure projects. This expected boom in employment without a commeasuring hike in output growth will be linked to certain large-scale projects expected to be carried out in the UK in 2022.

NON-METALLIC MINERALS

The **Non-metallic Minerals** subsector is best known for manufacturers that primarily supply the construction market with bricks, mortar, and glass. Construction activity, to which the subsector's performance is closely linked, accelerated towards the end of 2021. The outlook for the subsector is now more pedestrian, as a significant proportion of the construction activity backlog following the pandemic will now have been fulfilled or underway. As such, the output growth forecast for the subsector for 2022 stands at 2.4%, which is in line with the manufacturing industry average. Employment growth is forecast to experience modest expansion also, by 3.3%.

PHARMACEUTICALS

The **Pharmaceuticals** subsector has had extremely irregular output growth over the past two years, driven by the pandemic. Having seen explosive output growth in 2020 in the course of bringing pandemic related interventions to the market, growth cooled in 2021. It was expected in the last round of forecasting that the pharmaceuticals subsector would continue to see high single-digit growth in 2022, but a cooling in demand has seen that forecast turn to negativity. Output is currently forecast to contract by -8.8% in 2022. Employment is expected to follow suit, with the largest decline in employment expected out of all manufacturing subsectors, with a decline of -19.8%.

CHEMICALS

The **Chemicals** subsector growth closely tracked the performance of pharmaceuticals during the pandemic. As such, the revision to the Chemicals subsector forecasts mimics those of the Pharmaceuticals subsector. The output forecast has been downgraded to -5.2%, from what was already only a marginally positive outlook of 0.5% last quarter. Employment growth expectations are also contractionary, with the second-largest contraction out of all manufacturing subsectors, after Pharmaceuticals, of -11.1%.

RUBBER & PLASTICS

UK made plastics producers are currently the beneficiary, to a certain degree, of disrupted supply chains and global supply shortages, in that many buyers in the UK are turning to near-sourcing as a means of securing supply and generating resilience. In turn, this has significantly raised the output expectations of the sector compared to the previous round of forecasting.

While the UK's Rubber industry is very closely aligned with the performance of the Automotive sector in the UK, with so much UK rubber production going into the production of vehicle tyres, the modest outlook for the Automotive sector is not enough to drag drown the overall positivity expected to materialise in the **Rubber & Plastics** subsector. The current forecast for output growth for the subsector is a high 9.4%, the highest growth expectation in this round of forecasting. Employment is also expected to grow, albeit more modestly at 1.9%.

MOTOR VEHICLES (AUTOMOTIVE)

The **Motor Vehicles** subsector, having just seen its output growth expectations improve following shortfalls in output growth for two years, has unfortunately again seen expectations scuppered due to renewed supply challenges. In the last round of forecasting, the Motor Vehicles subsector was forecast to grow by 8.8%, now, three months later, that forecast has been revised all the way down to 0%, i.e. 'no change'. This means that the subsector will likely now take longer to recover lost output incurred by the pandemic than initially suspected. Nevertheless, there exists the silver lining which is that this output growth is not lost, but rather pushed back, as the output growth forecast for 2023 is comparatively high at 13.8%. Employment in the industry is expected to grow by 1.7% this year.

OTHER TRANSPORT

The **Other Transport** subsector, which encompasses a combination of aerospace, defence, shipping and rail manufacturing, was the only subsector to decline in gross value added output last year. Unfortunately, the trend of declining output this year is set to continue, if not worsen. In the first quarter of the year, the Other Transport subsector was forecast to decline by -0.2% in output this year, this has now been downgraded to -2.3%. However as international travel and pandemic-related logistics disruption eases, there is growth still expected for the sector in the future, with an output growth forecast for 2023 of 12.5%. Employment for 2022 is expected to grow, by 4.1%.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2021	2022	2023	2021	2022	2023
Basic metals	1.8	5.9	-2.3	0.9	-0.2	-0.2
Metal products	7.0	7.5	-2.2	0.5	2.2	0.6
Mechanical	14.6	4.6	-0.4	-3.8	-4.0	2.4
Electronics	1.4	3.1	1.5	-9.7	-4.1	-0.2
Electrical	8.6	-0.1	3.0	-1.2	10.2	4.3
Motor vehicles	3.1	0.0	13.8	-3.1	1.7	-2.9
Other transport	-5.6	-2.3	12.5	-5.6	4.1	0.3
Food & drink	4.2	3.3	1.4	4.6	1.9	-1.2
Chemicals	2.0	-5.2	0.3	0.3	-11.1	-3.8
Pharmaceuticals	3.7	-8.8	0.6	-7.4	-19.8	-5.7
Rubber and plastics	10.9	9.4	0.4	-9.1	1.9	4.0
Non-metallic minerals	15.1	2.4	2.4	-1.4	3.3	1.8
Paper and printing	13.3	1.8	-0.5	-8.4	-1.5	-3.2
Textiles	18.4	5.6	-1.9	-13.1	4.2	-6.7
Manufacturing	6.8	2.3	1.8	-2.6	0.5	-0.4

Source: Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

POST-PANDEMIC, WHAT ARE THE KEY CONSIDERATIONS FOR MANUFACTURING M&A?

Following an optimistic start to the year, our latest survey shows manufacturers are starting to feel the impacts of the multiple challenges they are facing, with the sector experiencing a slowdown across almost all our key indicators and prices rising for the fifth consecutive quarter.

The last couple of years have delivered unprecedented levels of disruption for business models in the manufacturing sector, with challenges from Brexit, COVID-19, tight labour markets, and supply-chain related issues. Yet 2021 saw an impressive surge in transactions involving UK manufacturers, with 31% more manufacturing deals completed than in 2020, and a greater volume than in 2019, pre-pandemic. So, what are the live issues for businesses considering an exit post-COVID-19?

PREPARATION

This is hardly a new topic – M&A advisers will always say "prepare properly". But we have seen new areas of scrutiny. A few examples to help shape your thinking:

- **ESG:** this continues to grow in importance. The introduction of 'carbon due diligence' is relatively new but a sign of the times.
- **Disaster recovery and scenario planning:** an area which has been tested to the full during the pandemic. It will be tested again during due diligence.
- **Grants and furlough:** the furlough scheme supported many through the pandemic and it involved new processes implemented in short timescales. HMRC are looking intently at claim integrity; expect buyers to do the same.
- **Working capital:** if HMRC payment deferrals were taken, consider the impact of the unwinding effect on net working capital and cash flows, while stretching of debtors/creditors will also impact the working capital dynamics.

UNDERSTANDING EARNINGS

How do you define 'business as usual' in the current environment? The answer is always sector and product specific. But whether a business has had a positive or negative impact from COVID-19, the answer is critical to value. You may start to hear the phrase "EBITDAC" (earnings before interest, taxes, depreciation, amortisation and COVID) – careful presentation and explanations to demonstrate sustainability of earnings is crucial.

WHAT ARE BUYERS LOOKING FOR?

The old adage "crisis creates change" is as true for M&A as every other walk of life. The strength of the M&A market has surprised many but is entirely logical where buyers need to re-position themselves for the future. Here are a few of the topics we see most commonly:

- **Supply chains:** these have seen significant disruption. The 'resilience v efficiency' spectrum has been shifted, and robust and reliable supply is paramount; onshoring or near-shoring to gain protection from future shocks is common.
- **Sustainability:** this is a major draw for investors, so brush off your environmental, social and corporate governance credentials.
- **Agile and resilient business models:** many business models have been proven in the pandemic as more able to capture market opportunities notwithstanding headwinds.
- **Automation and digitalisation:** more crucial when faced with labour shortages – the benefits are clear in terms of efficiency or potential for scale, as well as enhancing data capture and analysis.

The M&A market remains strong despite the effects of inflationary pressures on consumer confidence and the disruption arising from the Ukrainian conflict. If you're considering a sale or fund-raising, preparation and positioning is more important than ever to secure optimum success.

For more information on the current M&A trends in the manufacturing sector, read our recent manufacturing deals review: https://www.bdo.co.uk/en-gb/industries/manufacturing/report-manufacturing-deals-review

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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

IDEAS | PEOPLE | TRUST

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

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

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

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

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

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

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