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The Manufacturers' Organisation

# MANUFACTURING OUTLOOK

## 2023 QUARTER 2

With support from:

Scottish Engineering and Manufacturing NI

# FOREWORD

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The well-known idiom, 'the calm before the storm', saw its first recorded use in a 1601 play, becoming part of everyday English use by the 1800s. Less is known of its antithetical sibling 'the storm before the calm', yet perhaps it is the most appropriate descriptor of the times as following five years of the industry riding the rough seas the rocking of the boats seems to be easing.

Our sector has endured a circus of ill-fitting trading environments in this time, a revolving door of sideshows where not a moment emerged for the industry to take a breath. Now it would seem, if only for a brief moment, the onslaught is in recess.

Inflationary pressures have cast a long shadow over our sector, with rising costs of raw materials, energy, and transportation gnawing away at profit margins. These challenges have forced manufacturers to meticulously assess their operations, seeking ways to optimise efficiency and mitigate the impact of mounting input costs. The road ahead will undoubtedly be arduous, and there will be no quick fixes to these complex issues.

However, amidst these challenges, it is crucial to recognize the inherent strengths of the UK's manufacturing sector. Our industry has demonstrated time and again its ability to adapt, innovate, and find ways to navigate difficult economic conditions. The resilience that defines us remains unwavering, propelling us to innovate further and secure a prosperous future for both the industry and the jobs it provides.

Despite the inflationary headwinds, the short-term future does offer a glimmer of consistency. The UK's manufacturing sector has shown remarkable stability in recent quarters, showcasing consistent performance and maintaining a steady trajectory. While challenges persist, this steadiness instils confidence that our sector possesses the fortitude to hold its course.

The UK government's commitment to supporting the manufacturing industry through initiatives such as research and development tax credits, export assistance, and infrastructure investments is crucial in the competitive global manufacturing environment. However, where the sector is let down is the lack of a much-needed industrial strategy, a joined-up vision for the UK manufacturing sector that will afford businesses and investors alike the confidence needed to develop and support the industry over the next five to ten years.

Now is an opportune time, with the almost daily firefighting of business challenges slowing, a cohesive strategy which lays out the UK's objectives for the sector in the coming years will promote competitiveness and champion domestic production, a strategy that is of even greater salience given the renewed focus on domestic industry competitiveness seen in other major manufacturing nations as of late.

The coming year will prove defining for the sector's long-term prospects. As this period of calmer waters carries on into the second half of the year even despite the lack of immediate growth, the bolstering of confidence, investor appetite and trading consistency are the key activities that need to be rendered now to create the conditions required for accelerated growth in future years. We mustn't be complacent in the calm waters, as it doesn't take much to find ourselves amongst the dead calm.

# HEADLINES

Make UK's Q2 2023 *Manufacturing Outlook* report, in partnership with BDO, finds that manufacturers are experiencing their calmest operating conditions since the inception of the pandemic in 2020. The previous quarter's survey reported a remarkable rebound in activity following a contractionary end to 2022. Following these positive results manufacturers had raised their expectations for the current quarter expecting further growth.

Whilst the quarter-on-quarter change in balances between Q1 and Q2 is not nearly as outstanding as the previous quarter's change performance between Q4 2022 and Q1 2023 the easing of supply-chain disruption is having a positive impact on businesses' ability to deliver on their orders.

This is seen in the latest balance for output volumes which reported at +24%, up from +21%. In contrast, the balance for total orders has fallen from +28% to +21%, whilst this figure represents a slowdown it remains strong for the second quarter in a row. The more interesting feature the latest survey data reveals is that supply-chain disruption may be easing substantially as for the first time since Q2 2021 the balance for output has exceeded the balance for total orders. This indicates that a greater share of manufacturers is producing more than those that are placing orders whereas since 2021 scarce inputs and expensive logistics had made it very challenging to service high demand.

Businesses now expect this modest level of growth to continue into Q3 2023 as falling energy prices should enable businesses to produce more efficiently and result in a lower rate of inflation too.

The performance of orders when split between domestic and international performance is mixed. The domestic market has been a saving grace for manufacturers during a period where frictions to trade were high, not just due to the UK's exit from the EU but also from the high degree of supply-chain disruption that persisted over the last few years. Whilst the domestic market continues to perform well, it has shown a slight slowdown on balance, falling from +20% to +15%. However, export orders on balance have improved from +12% to +15% which is the first time exports have come to meet or exceed UK orders since Q4 2020.

The demand for labour remains high compared to historical averages but the balance in growth in Q2 has been roundly steady since Q1 reported at +18%. indicating that the jobs market may be slowing. In comparison, the balance for investment intentions was reported at +10%, down from +14%. Whilst this represents a slowdown it remains a healthy balance of firms that are still planning to invest more. Looking forward, however, manufacturers remain committed to increasing their hires as the economy grows faster than expected.

The rate at which the prices are increasing has slowed on balance at its fastest rate yet, giving the strongest indication that inflation may be easing at the production level. Yet the balances remain extortionately high suggesting we are far from being out of the woods. However, promisingly, the balances for margins are continuing to improve indicating that businesses are beginning to recoup their losses from last year.

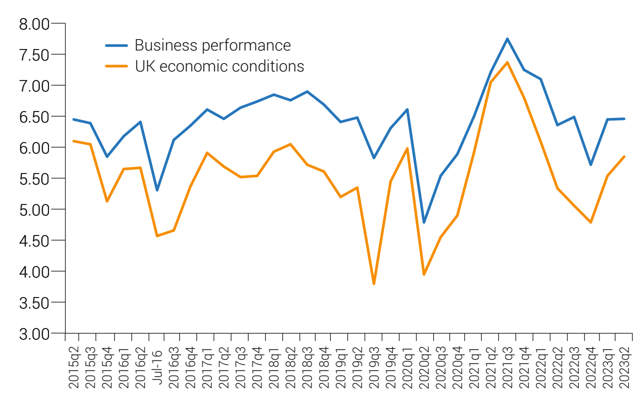
Business confidence remains positive but has improved only marginally since the previous quarter which indicates business conditions have not changed much since the start of the year. Moreover, economic confidence has improved much more in comparison as media stories regularly now forecast the UK will more likely grow in GDP than contract has helped sway businesses to feel more positive about the UK's prospects over the next 12 months.

| INDICATOR | BALANCE | CHANGE | |
|---|---|---|---|
| Confidence | 6.5 | ↑ | Business expectations stable and positive |
| Output | 24% | ↑ | Output volumes continue to grow |
| UK orders | 15% | ↓ | Domestic orders growth slows but remains strong |
| Export orders | 15% | ↑ | Exports continue to pick up |
| Employment | 18% | ↓ | Demand for workers continues to rise |
| Investment | 10% | ↓ | Investment intentions growth slows |

Source: Make UK Manufacturing Outlook Survey

### Manufacturer's expectations steady and positive

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




Source: Make UK Manufacturing Outlook Survey

# OUTPUT

*Manufacturing Outlook's* output metric, perhaps the most revealing indicator of the sector's quarter-to-quarter performance, has remained both moderately positive and stable in this second quarter research. While the scale of the balance figure doesn't indicate strong growth, certainly not in excess of the rate of growth we observed in the post-covid recovery period, it is the consistency of the performance compared to the previous quarter that allows for some much-needed optimism about the stability of the sector's performance in the coming quarters.

Since the middle of 2021, the start of the post-covid activity boom, despite the overall balance figure for output being high at the time, each following quarter saw the scale of that positivity decline right up until the final quarter of 2022, where the balance figure for output was only marginally positive, and manufacturers' expectations were firm that the first quarter of 2023 would bring about contractionary balance figures for output.

Instead what occurred, positively subverting expectations, was a first-quarter performance that was strong by comparison. Much of this expectation-bucking performance was due to a combination of falling wholesale energy prices, and more critically, sudden easements in supply chain delays and supplier lead times for critical components. It's this easement in the supply chain that allowed the sector to deliver finished goods at a rate far higher than expected last quarter.

bodes well for a sector that has been so fraught with variance in its performance metrics for the past few years. The last time that *Manufacturing Outlook's* output data demonstrated consecutive quarters of positive output balance figure consistency was at the start of 2018.

The balance figure for output this quarter stands at +24%, which is up slightly from the previous quarter's +21%. Continuing the trend of expected consistency, manufacturers have reported that they expect the balance figure for the third quarter of the year, as measured by our 'next three months' metric to be +22%.

The subsectors that have seen the largest relative positive changes to their output balances this quarter are, in order, Electronics, Metal products and Electrical, posting respective balance figures of +43%, +36% and +26%. In the case of the Electronics and Electrical equipment subsectors, output benefits in the short term are undoubtedly linked to the supply chain easements observed over the previous quarter given the high dependence on imports from the East that these subsectors have.

Interestingly, and unusually, when we look at output data by company size, as proxied by turnover bands, we see that it is the smallest group of companies, those in the £0-9m turnover category that have posted the largest positive output balance figures this quarter at +38%. Typically in *Manufacturing Outlook*

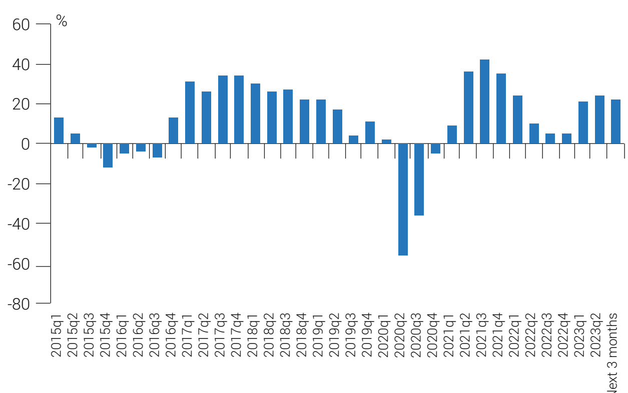
PAST THREE MONTHS ↑ 24%    NEXT THREE MONTHS ↓ 22%

However, the easement was a singular event, with the value it unlocked having been mostly cleared from UK manufacturers' stocks by the time of this publication in the second quarter of 2023. Nevertheless, the balance figure for output in this quarter has remained consistent, albeit improving slightly. It's this consistency, if only for two consecutive quarters, that

history, we see larger balance figures for those companies within those larger turnover bands, with smaller companies following over time. If we look at the future expectations balance figures for these company groupings, however, it transpires this phenomenon may be short-lived as it is expected that the £25m+ turnover band group of companies are expected to post the largest positive balance figure for output next quarter.

### Output balance growing at a stable healthy rate

% 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% | 50% |
| Metal Products | 36% | 22% |
| Mechanical | 18% | 30% |
| Electronics | 43% | 71% |
| Electrical | 26% | 4% |
| Rubber & Plastics | 13% | 88% |
| **TURNOVER** | | |
| £0-9m | 38% | 28% |
| £10-24m | 11% | 24% |
| £25m and over | 15% | 34% |

Source: Make UK Manufacturing Outlook Survey

# ORDERS

The total orders balance slowed slightly this quarter following a sharp rebound in growth at the start of this year. This is mainly a result of slowing growth in the domestic market, whilst export orders continued to catch up. However, this quarter's balance figure of +21% for total orders doesn't raise any genuine cause for concern. Instead, it suggests manufacturers could be experiencing a period of calm and stability for the first time since the pandemic.

Though it may be too soon to tell, we can say with a greater degree of certainty the unexpected bounce back which occurred at the start of the year may not be just a blip in the data. Manufacturers are finally reporting strong balances across all measures of orders, whilst the growth is not astronomical it is modest enough that can mean business as usual may be returning.

market's strength, this is the first quarter since Q1 2021 that UK orders have not exceeded export orders.

However, the subsector performance for producers of intermediate goods is positive this quarter. All subsectors, except for Mechanical, reported positive double-digit balances for domestic order performance indicating that upstream industries are performing better than the average UK manufacturer.

Then again, performance broken down by business size shows it is mainly the smallest turnover businesses (£0-9m) and largest (£25m+) that are reporting the greatest share of growth amongst manufacturers. Those in the middle (£10-24m) have reported weak positive balances. This scenario is consistent even with exports and total orders.

| | | | | | | |
|---|---|---|---|---|---|---|
| **UK ORDERS** | PAST THREE MONTHS | ↓ | 15% | NEXT THREE MONTHS | ↑ | 21% |
| **EXPORT ORDERS** | PAST THREE MONTHS | ↑ | 15% | NEXT THREE MONTHS | ↓ | 12% |
| **TOTAL ORDERS** | PAST THREE MONTHS | ↓ | 21% | NEXT THREE MONTHS | ↑ | 27% |

The biggest question that remains unanswered is for how long this modest growth can be sustained. Fortunately, the output gap has also narrowed so much that orders now trail behind the balance of output for the first time since the second quarter of 2021. This mark is the strongest indication from our survey that supply-chain disruption is easing with manufacturers producing goods at a greater rate than they are ordering inputs and components.

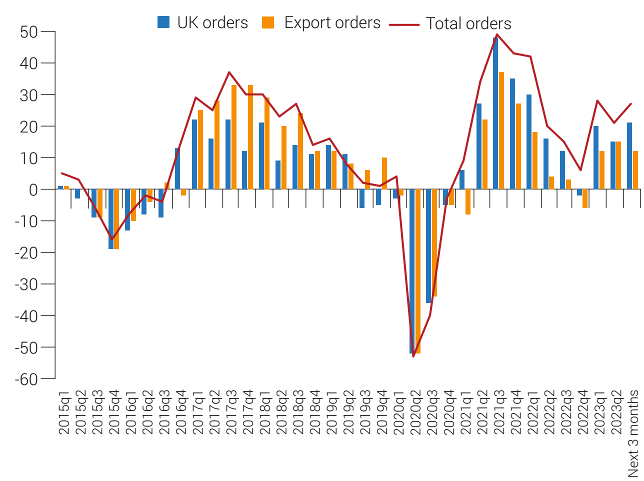
Expectations for the next quarter are mixed but the general view is the modest level of growth on balance should continue into the third quarter of this year. The total order balance is expected to improve to +27% which suggests new order growth should accelerate, albeit the balance will still be lower than the +28% reported in Q1.

## UK ORDERS

UK orders reported a positive balance of +15%, down from +20% in Q1. The domestic market has built a reputation for outperforming export orders consistently every quarter since the inception of the pandemic. Whilst the latest quarter's result continues to showcase the domestic

**Domestic market growth slows marginally, whilst exports improve**

% balance of change in orders




Source: Make UK Manufacturing Outlook Survey

## EXPORT ORDERS

Export orders reported a balance of +15%, a modest improvement from Q1 2023.

International orders have continued to recover since the fourth quarter of last year when exports fell for a balance of -6% of manufacturers. The performance of export orders since the pandemic left something to be desired, particularly when compared to its counterpart, domestic orders. However, the latest figure marks the first-time exports have matched the performance of the domestic market indicating that businesses overseas are also experiencing similar growth. This is reflected by the IMF which recently updated its forecasts for G7 nations predicting that no country should expect a decline in GDP for 2023.

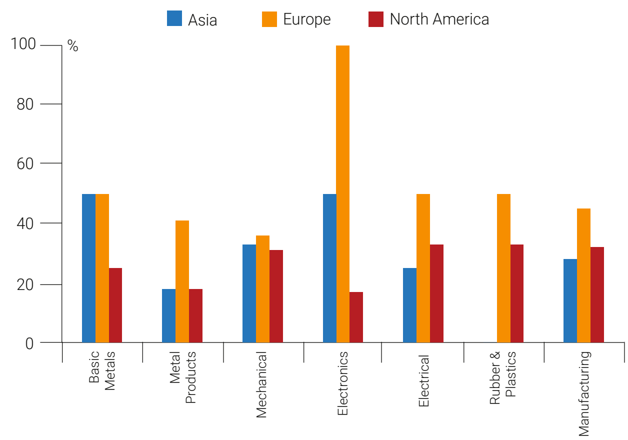
However, export orders are more volatile than UK orders partly because there are many external factors that the UK cannot easily influence, such as how businesses will respond to the significant investments being planned in the US under the guise of the Inflation Reduction Act (IRA) and the CHIPS and Science Act.

In addition, the UK is still negotiating a few free trade agreements with discussions with several major nations not yet leading to anything of material value, this includes both India and the US.

Manufacturers continue to report positive demand conditions from the rest of Europe. Similar to last quarter, Electronic manufacturers continue to report the strongest demand conditions in Europe which indicates there is high demand for new technologies and plant & machinery. North America remains the second strongest market for manufacturers and Asia completes the top three.

### Demand conditions for electronics remains very 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 | 25% | 50% | 25% | 50% | 0% | 75% |
| Metal Products | 51% | 26% | 12% | 0% | 44% | 19% |
| Mechanical | 5% | 26% | 16% | 24% | 11% | 42% |
| Electronics | 14% | 71% | 67% | 50% | 43% | 57% |
| Electrical | 14% | 14% | 26% | -11% | 30% | 13% |
| Rubber & Plastics | 25% | 88% | 50% | 50% | 38% | 63% |
| TURNOVER | | | | | | |
| £0-9m | 24% | 19% | 10% | 1% | 32% | 24% |
| £10-24m | 3% | 17% | 5% | 14% | 4% | 17% |
| £25m and over | 10% | 31% | 19% | 26% | 21% | 50% |

Source: Make UK Manufacturing Outlook Survey

# EMPLOYMENT & INVESTMENT

As has been seen in some other of Manufacturing Outlook's core metrics, Employment growth in the sector has remained roundly steady to that in the first quarter of the year. The same cannot be said for Investment intentions, which have seen a dip compared to the previous quarter's figures, although only a moderate one at that with the metric remaining firmly positive.

Compared to last quarter, the total number of live vacancies in the UK's manufacturing sector has declined by approximately 5,000, where it currently stands at 72,000[1] live vacancies. If we look at that same data as a ratio of vacancies in the sector per 100 roles employed within it, the figure is 2.9. This is the lowest this ratio has been since July 2021, with extraordinarily high levels of vacancies in the intervening period between then and now.

However, while it is likely most of the reduction in live vacancies is due to the roles being filled, some of the decline will be ascribed to roles that were pulled from the market due to being surplus to requirement. Nevertheless, the combination of our Employment metric data showing consistent growth over the past two quarters in manufacturers' headcount, combined with the reduction in national statistics vacancies testifies that the industry is successfully recruiting, albeit at a lesser scale than is desired given the heightened future employment intentions figure for Q3 which reveal manufacturers' intent to employ yet more labour.

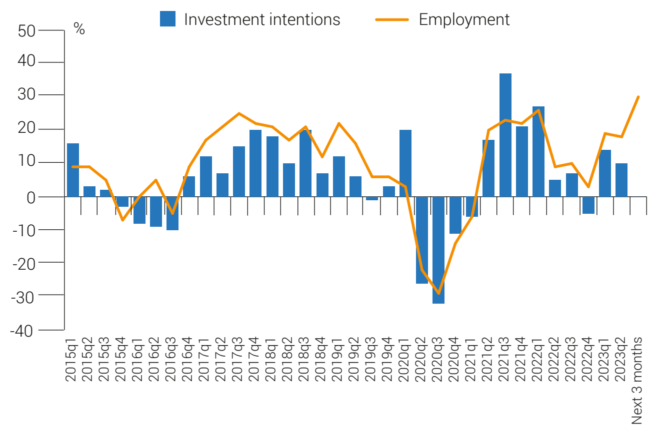
The Employment balance figure has declined by 1 percentage point, to 18%, and so too has the future 3-month employment balance figure, to 30%. While technically declines, these shifts are small enough to be considered consistent.

The Investment intentions metric, which measures manufacturers' intentions to invest over the coming 12 months, has dipped away from its warmly welcomed but unexpected high from the first quarter of this year. While the first quarter's balance figure was only a modest +14%, expectations from the start of the year had it forecast to be firmly negative, following a downward trend in overall metric performance in the previous year.

Now, in the second quarter, we can see that the same improving performance for Investment intentions has not continued, however, the balance figure reports a comfortable +10%, down from +14% last quarter. The unexpected Q1 growth in investment intentions from the year was most likely fuelled by suddenly easing supply-side limitations in the same period, which helped alleviate the shortage of input products from being the primary limitation to the ability to deliver finished goods.

**Investment intentions slow on balance but remains positive, labour demand still strong**

% balance of change




Source: Make UK Manufacturing Outlook survey

| | | | | | | |
|---|---|---|---|---|---|---|
| **EMPLOYMENT** | PAST THREE MONTHS | ↓ | 18% | NEXT THREE MONTHS | ↑ | 30% |
| **INVESTMENT** | NEXT TWELVE MONTHS | ↓ | 10% | | | |

### Employment and Investment summary

% balance of change

| | EMPLOYMENT | | INVESTMENT |
|---|---|---|---|
| **SECTOR** | **PAST THREE MONTHS** | **NEXT THREE MONTHS** | **NEXT TWELVE MONTHS** |
| Basic Metals | 25% | 50% | 25% |
| Metal Products | 31% | 28% | 23% |
| Mechanical | 10% | 28% | 10% |
| Electronics | 0% | 43% | 14% |
| Electrical | 9% | 35% | 10% |
| Rubber & Plastics | 25% | 50% | 50% |
| **TURNOVER** | | | |
| £0-9m | 25% | 33% | 11% |
| £10-24m | 7% | 15% | 16% |
| £25m and over | 17% | 27% | 16% |

Source: Make UK Manufacturing Outlook Survey

[1] ONS Vacancies by Industry data, Published 16th May 2023, accessed 5th June 2023

# PRICES & MARGINS

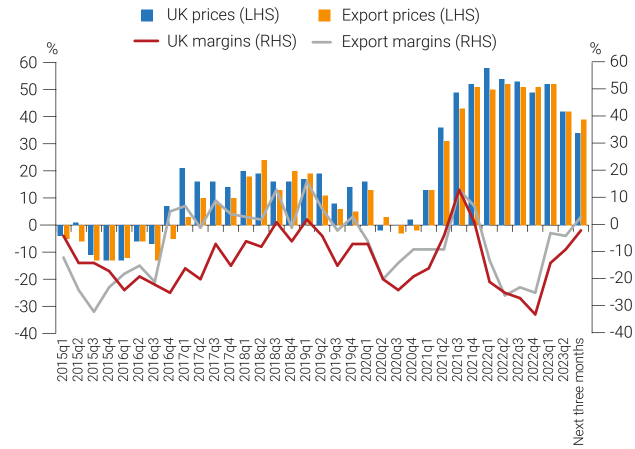
In this 2nd quarter edition of *Manufacturing Outlook* price growth for both manufacturers' UK prices and export prices has slowed at its most significant rate since the first quarter of 2021. Nonetheless, the balance figures for both price metrics remain high by historical standards. What's more important for the sector, however, has been the improving picture for margins performance.

While this quarter marks the 6th consecutive quarter where margins balance figures have been negative, the trend towards positivity is growing. Manufacturers' expectations for both UK margins and export margins are higher for the third quarter of this year than this quarter's figures. Export margins have declined by a single percentage point, however, this is a small shift and does not subvert the improving trend we have witnessed over the past few quarters, and indeed what we expect to see in the next.

While we expect margins to move into positivity by the end of the year, we have less reason to believe that price levels will fall commensurately in the same period. While price growth is likely to cool, we do not expect price growth

### Price inflation rate showing signs of easing, margins also continues to improve

% balance of change




Source: Make UK Manufacturing Outlook Survey

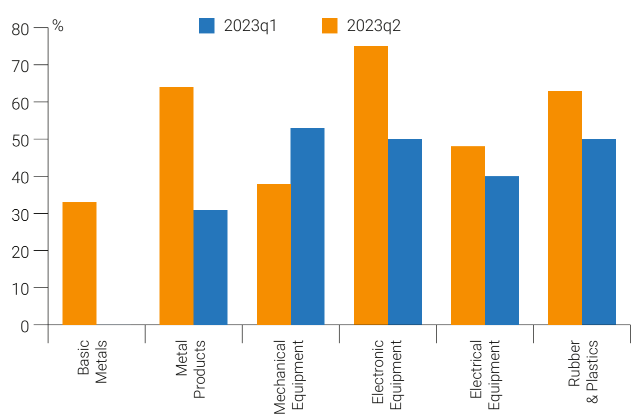
| | | | | | | |
|---|---|---|---|---|---|---|
| **UK PRICES** | PAST THREE MONTHS | ↓ | 42% | NEXT THREE MONTHS | ↓ | 34% |
| **EXPORT PRICES** | PAST THREE MONTHS | ↓ | 42% | NEXT THREE MONTHS | ↓ | 39% |
| **UK MARGINS** | PAST THREE MONTHS | ↑ | -9% | NEXT THREE MONTHS | ↑ | -2% |
| **EXPORT MARGINS** | PAST THREE MONTHS | ↓ | -4% | NEXT THREE MONTHS | ↑ | 3% |

activity to return to the normal levels observed over the past five years pre-2021. The foremost reason for this expectation is that price growth within the supply side has become embedded as the industry seeks to recoup the losses in the margins it has suffered over the six or so quarters prior. While this is a concern for the wider economy given the longer-term implications of upwards pressure on consumer price inflation, margins recovering in relation to prices will bring a much-needed benefit to the sector which has been suffering from margin erosion.

The balance figures for UK prices and Export prices are both +42%, which is a ten percentage point decline in both cases compared to the previous quarter. Despite this significant slowing in price growth, this +42% figure is still 35 percentage points higher than the average between 2015-2020 inclusively for UK prices, and 38 points higher than the same average for export prices. This highlights the still elevated nature of quarterly price growth despite this cooling.

### Export prices of intermediate goods still rising, but at a slower rate

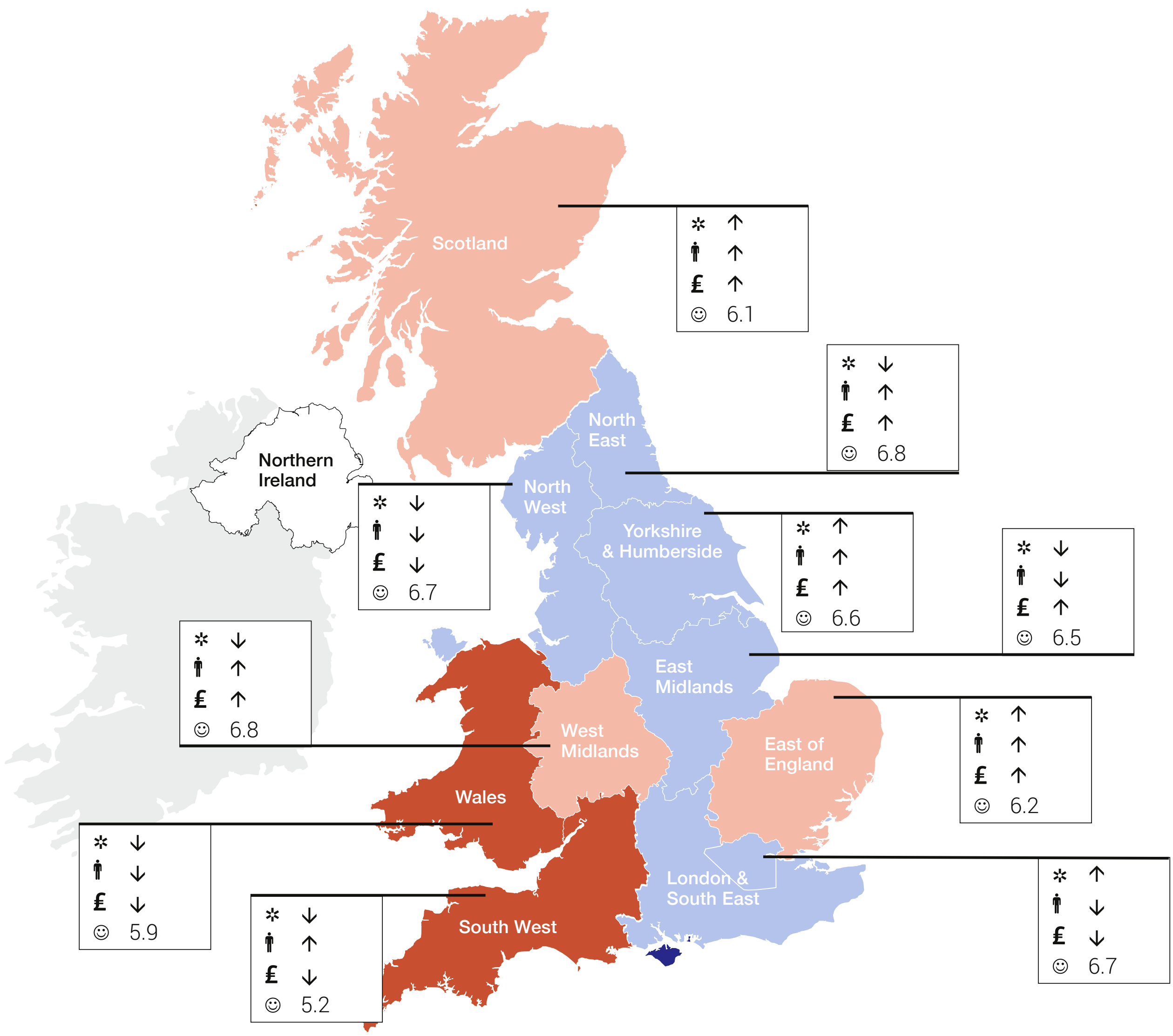
% balance of change in export prices in the past three months




Source: Make UK Manufacturing Outlook Survey

# NATIONAL & REGIONAL

Manufacturers' confidence improved marginally for this quarter. Though the change is minimal it is a positive outcome as it indicates there have not been any significant events to shift the beliefs that businesses have about their own operating conditions. In addition, the current average continues to exceed the '5' inflection point where positive confidence begins to overtake negative confidence across the sample.




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

Nevertheless, as expected there are differences amongst different regions or nations of the UK and not all are performing as well as the average business. Six out of ten regions or nations reported business confidence to be higher than the UK average. This includes Wales but not Scotland, which reported a business confidence level slightly lower than the national average.

However, the overall expectations of manufacturers are very positive and are reflected across other measured metrics, such as output and orders, which have given businesses a good reason to feel confident about the future. However, in some parts of the UK, such as Eastern, total orders contracted on balance between Q1 and Q2. Similarly in the South East and London, employment declined on balance in the last three months.

Headline business confidence was reported at 6.46, an increase of 0.01 from Q1 2023.

The largest improvement in business confidence was reported by the West Midlands, which increased by 0.9 points to 6.8. Not only the most improved, but the West Midlands is also the most confident region this quarter. This region boasts strong specialist subsectors such as automotive, mechanical equipment and metal products and it is possible the improved confidence is a result of these subsectors operating under better conditions, such as reduced supply-chain disruptions. The West Midlands is followed by the North East and East Midlands as the second and third most improved from last quarter.

Conversely, Wales reported the largest decline in confidence, falling by 1.6 to 5.9. This is followed by the same nation which reported the largest increase in confidence in Q1 2023 which suggests confidence may be more volatile in this region. Wales is followed by the South West and Eastern as the second and third most negative change since last quarter. The South West is also the least confident region when compared to the rest of the UK.

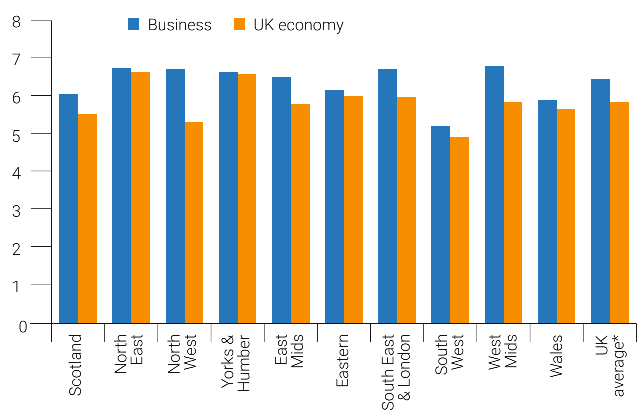
However, despite the variation in how the last three months have impacted manufacturers' confidence in different parts of the UK, every single region and nation remains above the 5-inflection point. This means across the board manufacturers in all parts of the UK are currently slightly more positive about the future than they are negative.

## UK ECONOMY CONFIDENCE

Manufacturers' views of the overall UK economy improved to 5.85, up from 5.54 last quarter. This improvement in economic confidence is substantially greater than the improvement reported for own business confidence. It is likely that recent revisions to UK performance expectations, such as by the IMF and Bank of England, who now expect the UK will not fall into a recession in 2023 have led manufacturers to feel more confident about how the wider economy will perform this year.

### Confidence levels mostly above the UK average in the North

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 | 34 | 32 | 24 | 20 | 28 | 37 |
| North East | 25 | 0 | 13 | 0 | 13 | 38 |
| North West | 0 | 17 | 11 | 22 | 17 | 6 |
| Yorks & Humber | 29 | 53 | 24 | 53 | 24 | 12 |
| East Mids | 57 | -14 | 43 | 0 | 14 | 36 |
| Eastern | 22 | -6 | -6 | 22 | 17 | 17 |
| South East & London | 38 | 50 | 44 | 53 | -16 | 19 |
| South West | 0 | 21 | 0 | 36 | 7 | 14 |
| West Mids | 12 | 20 | 28 | 44 | 16 | 36 |
| Wales | 0 | 0 | 11 | 11 | 11 | 22 |

Source: Make UK Manufacturing Outlook Survey

# ECONOMIC ENVIRONMENT

It was only one quarter ago when the International Monetary Fund (IMF) first forecasted that the UK would be the only country amongst the G7 to experience negative GDP growth this year. However, following the report that the industry was exceeding expectations for orders and output the IMF has changed its view now predicting the UK could grow by 0.4% this year. This improving picture is partly due to energy prices falling quickly and households are expected to benefit the most from it.

Whilst this is good news and will motivate businesses to continue growing despite persisting uncertainty, several headwinds remain which could still hamper growth expectations.

Besides the UK, Germany was also previously expecting their GDP to decline in 2023 according to Oxford Economics. However, their forecasts have been revised upward now predicting the country will grow by just 0.1%. Forecasts for China and India have also been revised up with both countries now predicting growth to exceed 4% in 2023. The overall global performance in the first quarter of this year suggests major economies are doing better than anticipated so far this year.

However, the positive performances being reported internationally may not be exactly music to the ears of central bankers who have been raising interest rates vigorously to curb inflation by eroding spending power. The latest statistics on consumer inflation show the 12-month average rate has dropped below 10% for the first time since April 2022, reporting at 8.7%.

Though this headline figure will send positive signals to those worried about the cost of business and the cost of living crisis, the figure masks the true nature of inflation today. The latest 12-month average figure is the first statistic published by the Office of National Statistics (ONS) to exclude the month the energy price cap was first lifted which has had the impact of bringing inflation down substantially. Additionally, food and drink inflation remains above 19% even when excluding the impact of the energy price cap and will impact the poorest consumers the most, who are less able to switch to cheaper products and services given they are likely to be using them already. This tells us that the time of high inflation is likely far from over and the Bank of England may still feel pressure to continue raising interest rates for the foreseeable future.

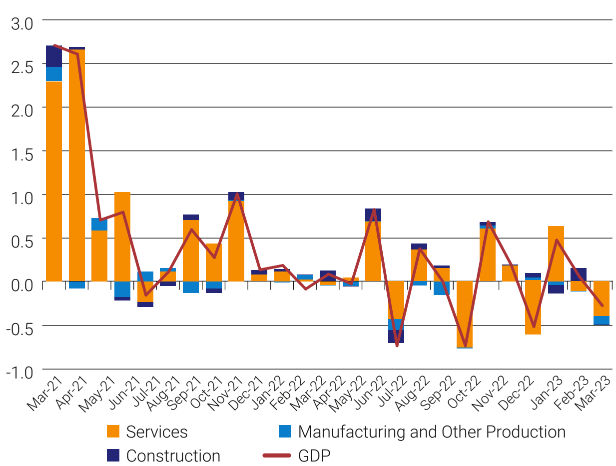
Fortunately, producer prices have been slowing at a greater rate, with the latest figures for produce price inflation (PPI) reporting at 3.7% for inputs and 5.4% for outputs. However, the 12-month period accounted for in producer inflation statistics does not yet account for the end of the Energy Bills Relief Scheme (EBRS) which has supported businesses through the energy crisis. Whilst the less generous new Energy Bills Discount Scheme (EBDS) could lead to PPI increasing from next month onwards, the falling of wholesale electricity prices suggests business costs pressures may ease somewhat this year.

The supply-chain disruptions that resulted from the pandemic raised concerns that the benefits of globalisation, such as lower costs, greater choice, and comparative advantages, had become an unreliable method of ensuring national security. In particular, the over-reliance on East Asian markets for materials and production capacity had for the first time become a disadvantage to manufacturing, as highlighted by the semiconductor challenge. Now western titans such as the US and European Union (EU) are gearing up plans to lead on climate change and securing semiconductor supply.

For example, the US Inflation Reduction Act (IRA) alongside the US CHIPS and Science Act and Bipartisan Infrastructure Law together includes over $2 trillion worth of fiscal

**GDP contracted marginally for the first time this year in March**

Contributions to monthly GDP, percentage points, March 2021 to March 2023




Source: ONS

interventions to increase domestic capacity in technologies of the future, mainly within the green sectors such as electric vehicle (EV) and battery production. The US aims to reduce its reliance on China, but the benefits of IRA could sway businesses in countries like the UK or within the EU if they perceive the programme to offer greater benefits relative to where they currently reside. In response, the EU has already developed its own EU Net Zero Industry Act, as part of a bigger ambition with the EU Green Industry Deal. Though they cannot compete with the US's deep pockets, the EU already has specialisms in renewables and is targeting growth in similar sectors, such as EVs, batteries, heat pumps and hydrogen.

The UK also has fiscal interventions in the pipeline, with £20 billion expected to be spent on carbon, capture, usage, and storage over the next decade as well as accelerating projects in small modular reactors (nuclear) and hydrogen. However, the plans pale in comparison to the US in terms of funding size and this could make it more challenging to attract foreign investment to the UK, especially when the US and EU are getting behind their industries more. For this reason, it is necessary for the UK to have an industrial strategy in place to ensure businesses can feel confident that their investments are going to a place that values manufacturing.

## UK Economic Forecasts

% change except where stated

| | 2022 | 2023 | 2024 |
|---|---|---|---|
| **TRADING ENVIRONMENT** | | | |
| Exchange rate (€/£) | 1.13 | 1.14 | 1.14 |
| Exchange rate ($/£) | 1.2 | 1.26 | 1.27 |
| Exports | 10.3 | -2.9 | 3 |
| Imports | 12.6 | -6 | 4.8 |
| Current account (% GDP) | -4.7 | -2.9 | -3.5 |
| **OUTPUT** | | | |
| Manufacturing | -4.8 | -0.5 | 0.5 |
| GDP | 4.0 | 0.4 | 1.3 |
| **COSTS AND PRICES** | | | |
| Average earnings | 6.0 | 5.2 | 2.9 |
| Oil price (Brent Oil $/bl) | 100.8 | 83 | 85 |
| **EMPLOYMENT** | | | |
| Manufacturing (000s) | 2,628 | 2,610 | 2,569 |
| Rest of economy (000s) | 36,046 | 36,180 | 36,275 |
| Unemployment rate (%) | 3.7 | 4.1 | 4.1 |

Source: Oxford Economics and Make UK

## International Economic Forecasts

% change

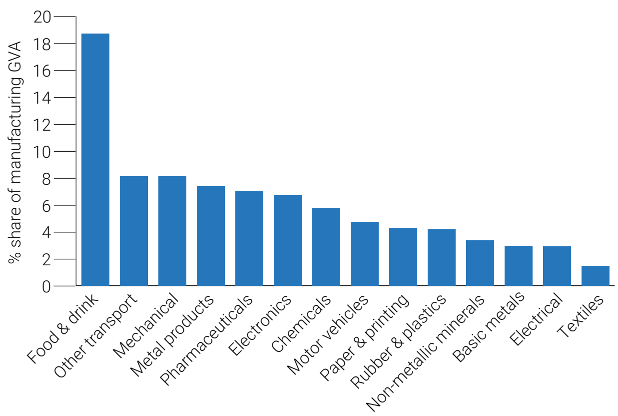
| | GDP | | | INFLATION | | |
|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2022 | 2023 | 2024 |
| US | 2.1 | 0.5 | 0.4 | 4.7 | 4.5 | 2.9 |
| Eurozone | 3.5 | 0.8 | 1.0 | 20.2 | 15.2 | 10.3 |
| France | 2.6 | 0.5 | 0.8 | 1.6 | 5.2 | 1.8 |
| Germany | 1.9 | 0.1 | 0.9 | 3.1 | 5.5 | 0.2 |
| Japan | 1.3 | 0.6 | 1.1 | -0.2 | 2.5 | 0.7 |
| China | 3.0 | 5.5 | 4.6 | 0.9 | 2.1 | 2.6 |
| India | 6.9 | 4.9 | 6.3 | 5.1 | 5.6 | 4.5 |
| World (2015 PPPs) | 3.1 | 2.0 | 2.2 | 7.8 | 5.7 | 3.5 |

Source: Oxford Economics

# SECTOR FORECASTING 23Q2

### Q2 2023 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added




Source: Oxford Economics

## FOOD & DRINK

The **Food & Drink** subsector, the largest subsector in manufacturing in the UK, has seen little shift in the total proportion of Gross Value Added (GVA) it contributes to overall manufactured output, at 18.7%. The subsector has received an upward revision to its expected output growth forecast for 2023, having previously been -2.4% last quarter, the revised figure is -0.3%, which is close to no decline at all. This is a marginally better forecast that the overall manufacturing average which is expected to decline by -0.9% in 2023. However, the forecast for 2024 output has declined from last quarter, with 0.9% growth expected in 2024. This follows a general trend in this round of subsector forecasting where we see improved figures for 2023, but flatter figures for 2024. Employment is expected to by 0.2% in 2023, and further by 1.4% in 2024.

## ELECTRONICS

The **Electronics** subsector has not only had one of the most positive significant revisions to its output forecast this quarter but also has the second-highest growth expected in 2023 out of all manufacturing subsectors. Much of the reason for the upgrade in this subsector's forecast is associated with a significant easement in supply chain disruption and delays for componentry coming from the East, which has improved the subsector's ability to deliver finished products. The output forecast is for 4.3% growth in 2023, but a flatter -0.5% in 2024. Employment is expected to change little in 2023 with a 0.2% change this year and a further decline of -2.9% in 2024.

## BASIC METALS AND METAL PRODUCTS

The **Basic** Metals subsector has also received an improved forecast for output in 2023, having previously held the most negative output forecast last quarter. The latest expectation for output growth in the sector is at -2.9% for 2023, which while improved, is still six times more negative than the manufacturing average. This contraction is forecast to continue into 2024, with a further decline of -7.8% in output expected. Employment is set to follow suit but with less magnitude, with a reduction of -1.2% in 2023, and a further more significant reduction in 2024 by -4.4%.

While the **Fabricated Metals** subsector usually sees its performance closely linked to the Basic Metals subsector, forecasts have diverged in recent quarters and this quarter is no exception. The forecast for output in this subsector has turned positive following a decline forecast in the last round for 2023, at 0.8%, which sees the subsector grow while the manufacturing average still remains in negativity this year. Growth continues in 2024 as well, with a further increase of 1.4% in output expected. Employment growth is set to be low but consistent this year and the next, with a growth of 0.5% in 2023 and 0.6% in 2024.

## MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector's forecasts often shift in line with overall investment intentions from the sector, due to it often being a recipient subsector of capital investment. With both the somewhat positive investment outlook, combined with an improvement in the sector's 2023 outlook, it follows that this subsector would see an improvement in its forecasts. Nevertheless, despite the forecast having improved this quarter, it still remains negative and also well below the average manufacturing forecast. Output for the subsector is expected to contract by -3.7% this year, and by a lesser -0.6% in 2024. Employment is not forecast to change much this year, with growth of 0.3% expected, but a contraction of -2.4% in 2024.

## TEXTILES

The **Textiles** subsector this quarter sees a slight improvement to its output forecast for 2023, but well below the improvements seen in other subsectors. With a forecast of -6.3% in output for 2023, the subsector has the second most negative output growth outlook for the year out of all manufacturing subsectors. The forecast for 2024 is far flatter, in line with the manufacturing average, at 0.6%. Employment is set to remain steady this year with only a growth of 0.3% forecast but with larger growth of 3.7% expected in 2024.

## PAPER & PRINTING

The **Paper & Printing** subsector, similar to others, has seen an improvement in the forecast for this year but nonetheless retains the third most negative change in output expected this year. Output is forecast to decline by -6% in 2023 but return to some growth in 2024, by 1.7%. Employment is set to decline consecutively over the next two years, with a decrease of -2.7% in 2023 and -2.1% in 2024.

## ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector has had a very significant improvement to its forecast for 2023. While it had previously held the worst expected decline for output out of all other subsectors, and continues to do so this quarter, the forecast has improved from a whopping -12.4% decline in output for the year to a more moderate -6.8%. Employment expectations are less drastic, with a decline of -2.1% forecast for 2023, and 1% growth in 2024.

## 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. This subsector is one of the very few that has seen its forecast worsen between the first and second quarter of the year, with an expected decline output of -4.8% this year and a small recovery of 1.6% in 2024. Employment, on the other hand, is expected to increase slightly in 2023, by 1.9% and remain somewhat flat in 2024 with a contraction of -0.8%.

## PHARMACEUTICALS

The **Pharmaceuticals** subsector, as it was last quarter, has the largest expected output growth in 2023 for output out of all manufacturing subsectors, albeit reduced from the high forecast of 9.2% growth last quarter to 5.3%. The 2024 forecast is more sobering, with only a moderate growth in output of 1.6% expected. Conversely, the subsector has the second largest expected decline in employment for 2023, at -3.5%, and an even larger negative forecast for employment decline in 2024 of -4.5%.

## CHEMICALS

The **Chemicals** subsector, which has historically trailed the performance of the pharmaceuticals subsector, continues to diverge in terms of its output performance forecasts. Having stood at an expected -6% decline in output for 2023 last quarter, the new forecast is only marginally improved with a decline of -5.8% expected. The decline is expected to recover just a little in 2024 by 1.5%. Employment, not unlike that of its close cousin the pharmaceuticals sector, is expected to decline in both 2023 and 2024, by -5.1% and -2.4% respectively, meaning the subsector holds the most negative forecast for employment decline for 2023 out of all subsectors.

## RUBBER & PLASTICS

The **Rubber & Plastics** has seen a remarkable improvement on what was previously a contractionary forecast for output this year. Now improved up to 2.2% for the year, this represents approximately a seven percentage point rise. It is forecast that the sector will retain this growth into 2024, with only a very slight decline of -0.2% expected. Employment is also forecast to grow in 2023, by 2.8%, but for 2024, a lesser decline of -1.4%.

## MOTOR VEHICLES (AUTOMOTIVE)

Another positively revised forecast for the **Motor Vehicles** subsector will be welcome news for an industry that suffered such large declines in output in 2022. With 4.4% growth in output forecast for 2023 it signifies a three percentage point uplift on the previous forecast . Growth, albeit at a slower pace, is set to continue into 2024 as well, by a further 1.6%. Employment will also grow this year, by 1%, but is forecast to decline by -3.6% in 2024.

## OTHER TRANSPORT

The **Other Transport** subsector, which is comprised of aerospace, defence, shipping and rail industries, has seen its forecast raised following a flat forecast for the year in the first quarter, now standing at 2.3% output growth for 2023. Yet further growth is expected in 2024, at an even greater rate than in 2023, by 3.2%. Employment is forecast to grow and decline by equal measure between this year and the next, with an expansion of 1.1% forecast this year but a commensurate contraction in 2024 by -1.1%.

### Sector growth rates and forecasts

% change

| | OUTPUT | | | EMPLOYMENT | | |
|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2022 | 2023 | 2024 |
| Basic metals | 1.4 | -2.9 | -7.8 | 3.0 | -1.2 | -4.4 |
| Metal products | -11.1 | 0.8 | 1.3 | 0.8 | 0.5 | 0.6 |
| Mechanical | -10.3 | -3.7 | -0.6 | 1.4 | 0.3 | -2.4 |
| Electronics | -5.9 | 4.3 | -0.5 | 1.5 | 0.2 | -2.9 |
| Electrical | -12.4 | -6.8 | -1.2 | 6.1 | -2.1 | 1.0 |
| Motor vehicles | -12.0 | 4.4 | 1.6 | 0.3 | 1.0 | -3.6 |
| Other transport | -4.7 | 2.3 | 3.2 | 2.8 | 1.1 | -1.1 |
| Food & drink | 0.5 | -0.3 | 0.9 | 0.4 | -0.2 | -1.4 |
| Chemicals | -5.5 | -5.8 | 1.5 | 4.0 | -5.1 | -2.4 |
| Pharmaceuticals | -3.3 | 5.3 | 1.6 | 7.0 | -3.5 | -4.5 |
| Rubber and plastics | -9.7 | 2.2 | -0.2 | 4.7 | 2.8 | -1.4 |
| Non-metallic minerals | 3.1 | -4.8 | 1.6 | 2.7 | 1.9 | -0.8 |
| Paper and printing | -5.7 | -6.0 | 1.7 | 3.2 | -2.7 | -2.1 |
| Textiles | -3.3 | -6.3 | 0.6 | 7.9 | 0.3 | 3.7 |
| Manufacturing | -4.8 | -0.5 | 0.5 | 3.4 | -0.9 | -1.6 |

Source: Oxford Economics

Source: Oxford Economics

# BDO VIEWPOINT

## DIGITAL TRANSFORMATION: AN OBSTRUCTION OR AN OPPORTUNITY?

Following a strong start to the year, this quarter manufacturers have maintained performance levels, with output and orders remaining steady. Despite prices remaining high, manufacturers' margins are steadily moving towards positivity. However, this is not the case when it comes to investment intentions, with the latest quarterly data showing that momentum has been lost in the second quarter of the year.

Investment growth is particularly key when it comes to digital transformation. Without meaningful funding, the success and longevity of that transformation can be severely impacted. Instead, digitalisation is based on weak foundations that simply cannot shoulder tangible change.

So, with margins still being stretched, why should manufacturers embrace digital transformation and what does it mean to a sector ripe for change?

## WHAT IS DIGITAL TRANSFORMATION?

Digital transformation is the process of embracing technology across a business to drive change.

We can often confuse digitisation with digitalisation. Digitisation is the process of taking simple analogue data and making it digital; digitalisation, on the other hand, is about fundamentally changing how you do something, and using technology to achieve it.

## DIGITAL TRANSFORMATION IN MANUFACTURING

The biggest challenge we are seeing across the manufacturing landscape with respect to digital transformation is the integration of different systems that are all designed for different purposes and the migration of system hosting into the cloud.

Previously, back-end finance systems would be segregated from front-end processes and systems – for example a sales system. Today, those functions and processes are being integrated to create a seamless, end-to-end process, building interconnectivity between separate systems.

Why does that matter? It means:

- Optimising what is currently a fragmented process by reducing manual activity to connect key information between system A and system B.
- Improving the customer experience through the provision of access and visibility to the manufacturing cycle. In a world where we now have information at our fingertips, transparent and continuous customer engagement is a real differentiator.
- Empowering employees, moving them away from acting as a manual system integrator and allowing them to focus on value-added activity.

## KEY CONSIDERATIONS AROUND DIGITAL TRANSFORMATION

The challenge in manufacturing is the value chain; the further you travel along that value chain the more eroded profit margins become. With the level of capital needed to fund digital transformation projects, cash flow can often be a barrier to entry. As such, manufacturers need to take a more medium to long-term approach to digitalisation, as you're unlikely to see the benefits straight away.

Failure can also come by not having the right vision, or not having a vision at all. During the COVID-19 pandemic, many companies chose to embrace digital transformation as a means of tackling the plethora of challenges being thrown at them. It resulted in impulse decisions, with automation built on top of sub-optimal technology.

The other important consideration is around culture. If you're transforming a business, you need people to change their habits and buy into new ways of working. Without it, digital transformation projects are likely to be short-lived.

## OBSTRUCTION OR OPPORTUNITY?

Ultimately, digital transformation will help to deliver efficiencies, provide transparency and visibility, as well as achieving a return on investment. If you want to stay relevant, particularly with AI on the horizon, then it's essential to get on board to prevent being pushed out of the market. To remain competitive in a cost-conscious environment, digital transformation really is the only way forward.

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IDEAS | PEOPLE | TRUST

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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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