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MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2023 QUARTER 1

With support from:

Scottish Engineering
and Manufacturing NI

FOREWORD

Seamus Nevin
Chief Economist
Make UK

Richard Austin
Head of Manufacturing
BDO LLP

The practice of forecasting goes as far back as ancient Egypt where members of royal courts would advise its government on everything from crop growth to labour supply and even battle strategies in war. Their ability to forecast accurately was so valued, that giving bad advice or incorrect predictions were punishable. Back then these people were likely referred to as psychics and were known to use existing information to inform others. Of course, back then that information primarily consisted of what was seen in dreams or the stars.

Civilisation has moved on substantially since then, today we are collecting data on everything from consumer behaviour to our carbon emissions. With an abundance of information many analysts and economists continue to attempt to accurately forecast the future to better advise decision-makers in government and business. As our latest survey results show, manufacturers continue to operate in a highly uncertain environment which has made it very difficult to plan and invest.

There was a genuine concern that this year could be a more difficult year than the last, with inflation, supply-chain disruption, high energy bills and labour shortages creating barriers to business growth. Manufacturers themselves had initially assumed that the first quarter of 2023 would be quiet and lacklustre in performance, with the rest of the year filled with uncertainty as Government support is pulled or reduced. Nevertheless, the latest spring budget highlighted that the super-deduction will be replaced by full expensing for another 3 years, which will support manufacturer's investment plans.

However, businesses bucked the trend in our latest Make UK and BDO Manufacturing Outlook survey. Many manufacturers this quarter have reported output volumes have increased contrary to expectations. Much of this growth has been dominated by a number of manufacturing subsectors, namely electronics, mechanical equipment and metal products who all posted strong positive balances for this quarter. Similarly, the growth in output is more than matched by the growth reported in total order books which have made a sharp U-turn following a year of quarter-on-quarter slowdowns.

The only thing that hasn't surprised us this quarter is that the domestic market continues to outperform expectations, whilst export orders have done better, they continue to trail behind UK orders. It's great news that many manufacturers have been able to rely on domestic demand to continue operations, but it is important we do not forget the growth that can be achieved overseas.

Although official statistics show the rate of inflation is beginning to cool, manufacturers continue to raise prices on their goods. Whether this is driven by a need to recoup lost profits from last year, or an insurance policy to protect margins in the future this is down to the individual business. Unfortunately, margins remain in negative territory this quarter which suggests most manufacturers are still making losses. On a brighter note, manufacturers are forecasting margins to be back on the up again next quarter which will help businesses recover, if these expectations are near accurate.

However, manufacturers will not be able to turn profits just by raising prices on their goods. Access to labour and skills will remain a barrier to growth this year despite the improvements seen in production and orders. The vacancy rate remains near record highs even now with more than 3 jobs vacant for every 100 roles in manufacturing. The government's approach to "Returnerships" for Over-50's and increasing childcare support for working parents may result in some benefit to manufacturers, but such interventions need to be coupled with adequate investment in skills.

Our latest survey findings have given us much to be enthusiastic about with green shoots of growth beginning to take shape. But caution is now an ingrained feature in the mindsets of decision-makers, as well as for forecasters who are more likely to advise more cautiously in the future.

HEADLINES

Make UK's Q1 2023 *Manufacturing Outlook* report, in partnership with BDO, finds that manufacturers have unexpectedly improved on their performance compared to the previous quarter following months of slowing activity.

However, whether the latest survey findings signal a resurgence of growth and investment or a one-time blip in the data remains to be seen. Due to this, the latest forecasts remain cautious in their predictions and expect manufacturing output may still decline overall this year relative to 2022.

The Output volumes balance bounced back this quarter increasing from +5% to +21%, the highest balance level since Q1 2022. However, manufacturers failed to predict the latest survey findings, initially forecasting an overall contraction for the first quarter of this year. This discrepancy between actual performance and predicted performance highlights how uncertain the business environment is for manufacturers with many businesses unable to accurately forecast their output and orders even just a few months ahead.

between now and Q2. Similarly, Investment Intentions increased from -5% to +14% as growing order books, supply-chain disruption easing, and cooling inflation has allowed businesses room to focus on the future and less so on short-term issues.

In contrast, price growth remains elevated as manufacturers continue to raise prices to recoup lost margins from last year. On a positive note, manufacturers' attempts to recoup profits appear to be working according to the latest survey findings which suggest, whilst UK and Export Margins remain negative on balance, it is trending upwards again with an expectation that margins could be in growth by next quarter.

Both business confidence and UK economy confidence improved this quarter. This was due to improvements in most UK nations and regions who are feeling slightly more positive about the next twelve months, except for the West Midlands which reported a marginal decline (despite remaining overall more positive than negative about the future).

INDICATOR	BALANCE	CHANGE	
Confidence	6.5	↑	Business expectations turn more positive
Output	21%	↑	Output volumes indicate expansion
UK orders	20%	↑	Domestic orders leading demand growth
Export orders	12%	↑	Exports rebound following contraction last quarter
Employment	19%	↑	Hirings accelerate to meet higher demand
Investment	14%	↑	Investment intentions improving

Source: Make UK Manufacturing Outlook Survey

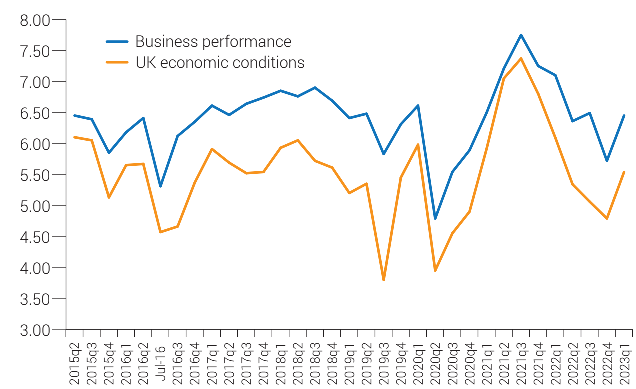
In this case, failing to predict higher than expected order books is the kind of problem most businesses would like to have, in respect to the reverse if orders were lower than expected instead. Furthermore, the survey reports Total orders on balance increasing from +6% to +28%. The order books growth may be a result of supply-chain disruption easing for some businesses with freight capacity improving and becoming cheaper to access too. Nevertheless, shortages of several raw materials and components remain such as various plastics, chemicals and metals.

The resurgence in Total orders is led by remarkable growth in the domestic market. After falling into negative territory (-2%) in Q4 2022 the balance of manufacturers reporting increasing UK orders improved to +20%. The export markets reported a similar rebound improving from -6% to +12%, but as has been the case since mid-2019 its growth continues to trail behind the domestic market.

Both Employment and Investment Intentions increased on balance compared to last quarter. The improvement in the latter metric is particularly interesting as manufacturer's confidence in investment plans had recently hit negative balances just one quarter ago. The Employment balance increased to +19% this quarter and manufacturers predict further hirings will take place

Manufacturer's expectations turn more positive

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

The results of the first quarter of 2023 suggest manufacturers may be resettling on a path to recovery following a challenging period of slowing demand last year. Equally so, the possibility remains that the latest results reflect abnormal business cycles as the UK economy is still adjusting following the pandemic and the recent energy crisis. Whatever the situation is, it is good news that manufacturers have had a strong start to the year.

The survey finds that the output balance has increased to +21%, over four times higher than the balance in the previous quarter (+5%). This is the highest balance of manufacturers reporting increasing output volumes since the first quarter of 2022, which means we cannot rule out the probability that this growth is cyclical or a blip in the timeseries.

The most surprising aspect of this quarter's results is how far they surpassed the expectations set by manufacturers last quarter. Manufacturers initially predicted that the Q1 2023 balance for output would be -1%, an overall contraction in the sector. It was the first time businesses had set negative expectations since early 2021 which highlighted just how much confidence had fallen amongst businesses.

Next quarter manufacturers forecast an output balance of +32%, a promising expectation. Whilst business forecasts should be taken cautiously given the first quarter results were far from expectations already, these expectations do indicate that manufacturers feel more upbeat about future performance. Nevertheless, several challenges remain which could hamper activity this year such as reduced support for energy bills, high levels of inflation in inputs and geopolitical uncertainty.

The growth in output may be explained by the performance of certain manufacturing subsectors. For example, Metal Products, Mechanical Engineering and Electronics all produced very positive output balances indicating growth this quarter. Basic Metals also reported a positive balance of +33%, but this was a decline on last quarter's +50% indicating some slowdown for these manufacturers. Growth in these subsectors suggest demand may be increasing for capital goods and raw materials used in the production or process of heavy machinery. Conversely, Electrical Engineering and Rubber & Plastics reported negative balances indicating that this quarter's promising growth is not being shared equally by all manufacturers.

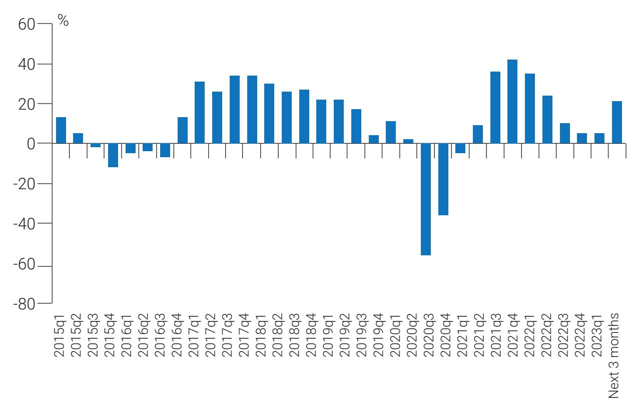
OUTPUT PAST THREE MONTHS ↑ 21% NEXT THREE MONTHS ↑ 32%

However, the inability to accurately predict output even just three months ahead suggests manufacturers are still operating in a highly uncertain environment where order books can rise at any moment. Most businesses would consider this issue to be less problematic than the reverse situation, where growth was expected but failed to be achieved. Yet, the ambiguity of tomorrow makes planning more difficult as demand can begin to slow again at a moment's notice.

Considering performance by business size also shows that a greater share of higher turnover manufacturers (£25m+) are increasing output volumes than the share of lower turnover manufacturers (<£25m). Indeed, an output balance of +24% for high turnover businesses, compared to an output balance of +13% (£0-£9m turnover) and +12% (£10m-£24m) for smaller businesses indicates that growth may be reaching larger business at twice the rate of smaller manufacturers.

Output volumes increase as supply-chain disruptions ease

% 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	33%	-33%
Metal Products	23%	26%
Mechanical	13%	42%
Electronics	29%	29%
Electrical	-6%	15%
Rubber & Plastics	-22%	0%
TURNOVER		
£0-9m	13%	33%
£10-24m	12%	32%
£25m and over	24%	31%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The Total orders balance increased sharply this quarter marking the first time demand accelerated relative to the previous quarter since mid-2021. As has been the case since 2019, most of this growth is attributed to a rebound in domestic market activity, albeit the export markets have also indicated an improvement.

This quarter the Total order balance reported at +28%, up from +6% in Q4 2022. The rising share of manufacturers seeing increasing order books will be promising news to the sector as it attempts to outperform market expectations this year.

period began following the pandemic. As new trading arrangements between the UK and European Union (EU) came into effect and supply-chain disruption increased manufacturers were able to rely on domestic demand to fulfil their needs. This was proven even in times of decline where UK orders demonstrated more resilience in downturns than export orders as last quarter contractions in the domestic market were less pronounced than what was observed in the international market.

The subsector performance highlighted a mixed picture in the domestic market as Mechanical Equipment and Electronics both outperformed the UK average indicating

UK ORDERS	PAST THREE MONTHS	↑	20%	NEXT THREE MONTHS	↑	23%
EXPORT ORDERS	PAST THREE MONTHS	↑	12%	NEXT THREE MONTHS	↓	10%
TOTAL ORDERS	PAST THREE MONTHS	↑	28%	NEXT THREE MONTHS	↓	23%

One area of concern arising from the expansion of activity is the gap between output and orders, which has widened again, with the balance of the latter exceeding the former by +7%. Shortages of raw materials such as semi-conductors, aluminium, plastics and even food have caused difficulties for production for almost two years now. Whilst disruption is easing for some businesses, particularly as freight capacity returns, the widening output gap suggests not all businesses are prepared to meet demand spikes on short notice.

Expectations for next quarter present a mixed picture, however, as businesses predict growth to accelerate in some areas, order books growth may also slow down again between now and Q2. Businesses forecast a balance of +23% for Total Orders next quarter, just slightly below the current balance indicating some manufacturers expect continued growth but at a slower rate. Nevertheless, a balance of +23% would be a strong performance if manufacturer's expectations are accurate.

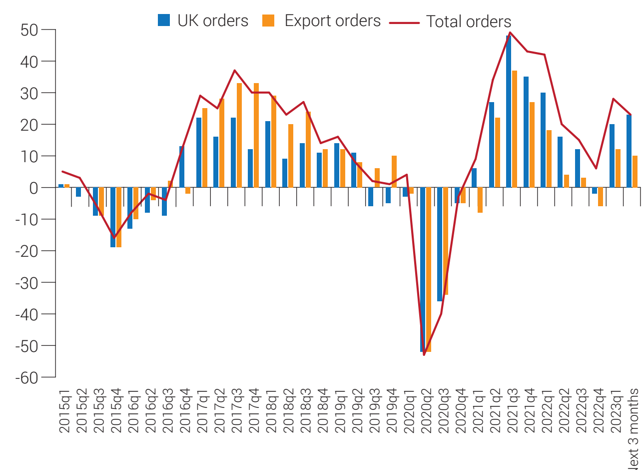
UK ORDERS

UK orders reported a positive balance of +20% following a small contraction last quarter. The domestic market has been a success story in the UK since the recovery

an increase in demand for capital goods and digital technologies. While it is not clear what is causing the spike in demand for goods from these subsectors, it is promising

Order books growth rebounds to the highest level since Q1 2022

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

given these industries cater to investment activity amongst manufacturers, particularly in plant and machinery.

However, Electrical Equipment, Rubber & Plastics and Basic Metals all reported negative balances indicating that the domestic market may not be resulting in a positive experience for all. These industries may be more exposed to raw material shortages that have been ongoing for a significant period now.

EXPORT ORDERS

Export orders reported a balance of +12%, significantly improved from Q4 2022.

Orders from customers overseas have been more volatile over the last few years with supply-chain disruption having a greater impact on business's ability to trade, making the domestic market a relatively easier place to do business. However, due to the complexity of supply-chains even those businesses that trade exclusively domestically may still be impacted by poor export performance if their customers rely on demand from abroad to stay afloat.

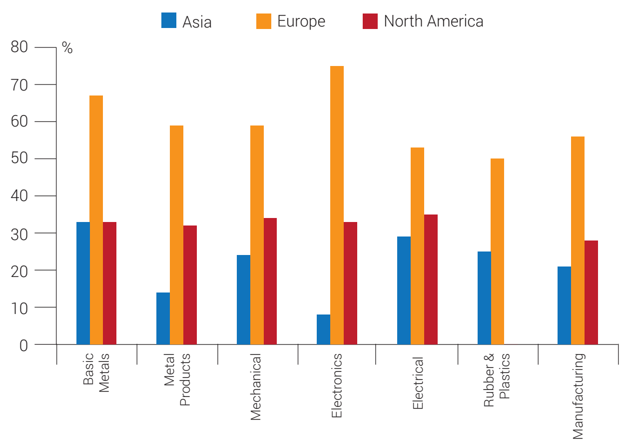
However, recent developments with the Northern Ireland Protocol may help reduce uncertainty in the trading environment as manufacturers have more clarity on how goods will be managed in the future when trading between Great Britain and Northern Ireland. This does not mean that trade will be any easier for businesses as there will still be more frictions than there were in the past, but some extra certainty is welcome.

The survey results also indicate that larger manufacturers are outperforming smaller manufacturers by a significant margin on balance. The smallest manufacturers (£0-£9m turnover) reported a balance of +2%, in comparison the largest manufacturers (£25m+) reported a balance of +19% highlighting a sharp difference in performance.

Manufacturers continue to report positive demand conditions from the rest of Europe despite weakening export orders. In particular, Electronics manufacturers have benefitted from better demand conditions, with 75% of manufacturers in this subsector reporting increased sales in Europe. North America remains the second strongest market for manufacturers and Asia completes the top three.

Demand conditions for electronics pick up 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	-33%	-33%	33%	-33%	-33%	0%
Metal Products	17%	15%	-9%	-3%	16%	9%
Mechanical	24%	36%	14%	12%	35%	38%
Electronics	57%	50%	67%	58%	64%	21%
Electrical	-6%	0%	-12%	8%	12%	15%
Rubber & Plastics	-11%	11%	-38%	-38%	11%	0%
TURNOVER						
£0-9m	16%	21%	2%	7%	20%	24%
£10-24m	-1%	28%	4%	18%	9%	22%
£25m and over	4%	8%	19%	9%	29%	18%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

Employment and Investment intentions, along with other metrics in this quarter's edition of *Manufacturing Outlook* have improved markedly since the previous quarter's edition and have exceeded expectations in doing so. This is of particular interest with regard to investment intentions, as this uptick has pulled the metric out of its one-quarter period in negativity, returning now to its highest level since the second quarter of 2022.

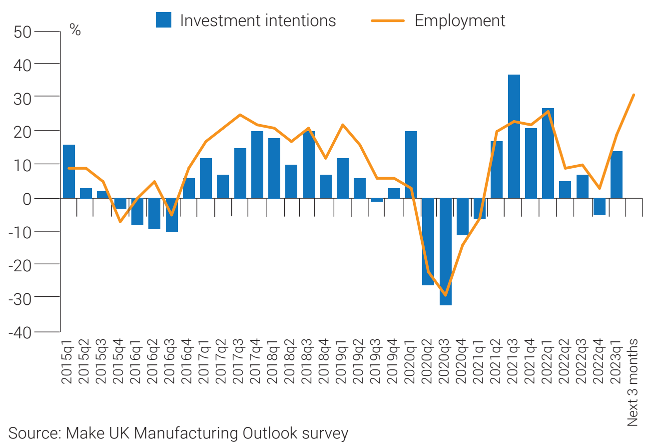
The increase in levels of employment growth we see this quarter is reflected in national statistics data which has recorded a decline in the number of total live vacancies in the UK's manufacturing sector, which currently stands at 77,000. This is a decline from November's data which recorded 85,000 vacancies in the sector. Currently, as a ratio, for every 100 jobs in the manufacturing sector there are 3.2 vacant.

The intention for manufacturers to continue growing their headcount is illustrated by the future 3-month employment expectation which has also grown significantly since last quarters' future expectation, which was quite muted given the trend towards a pessimistic outlook at the end of 2022.

capacity to produce output. While industry may have been getting ready to move to a battle footing last quarter, where capital expenditure funds are repurposed for contingency,

Following a slow end to 2022, manufacturers are restarting hiring and investment activity

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑ 19%	NEXT THREE MONTHS	↑ 31%
INVESTMENT	NEXT TWELVE MONTHS	↑ 14%		

This quarter's balance figure for employment stands at +19% with next quarter's expectation even higher at an impressive +31%. However, while the turnaround in employment intentions across one quarter comes as a positive sign for the industry's prospects, the ongoing labour shortage that the industry has been suffering with over the past few quarters will only exacerbate as demand for labour spins back up.

The Investment Intentions metric, which measures manufacturer's intentions to invest in capital over the coming 12 months, has returned to positivity following a one quarter spell in negative territory. The balance figure recorded for investment this quarter is +14%, up from -5% only three months ago. Leading this improvement in optimism, and in turn investment prospects, has been the easing of supply side limitations. The rate of input inflation has cooled better than expected, with particular attention paid to the rate at which the wholesale energy market has cooled. Further, supply change challenges have eased in the first quarter of the year, unlocking the industry's

the unexpected improvement in business conditions have allowed businesses to return to planning for capital investment in the coming year, at least for now.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	**PAST THREE MONTHS**	**NEXT THREE MONTHS**	**NEXT TWELVE MONTHS**
Basic Metals	67%	0%	-33%
Metal Products	16%	16%	10%
Mechanical	5%	36%	2%
Electronics	21%	21%	29%
Electrical	6%	21%	31%
Rubber & Plastics	-22%	0%	-33%
TURNOVER			
£0-9m	9%	32%	9%
£10-24m	22%	25%	16%
£25m and over	9%	15%	7%

Source: Make UK Manufacturing Outlook Survey

[1] ONS Vacancies by Industry data, published 14th February 2023, accessed 2nd March 2023.

PRICES & MARGINS

With this edition of *Manufacturing Outlook*, we are now in the 9th consecutive quarter of elevated price metrics, where manufacturers have consistently raised both their UK prices and Export prices far beyond the norm quarter-to-quarter since the first quarter of 2021. The change this quarter, encouragingly, is that the rate of margin decline has slowed with an expectation for margins to return to positivity by the second quarter of this year.

Over the past year, the dichotomy of increasing prices and declining margins had fuelled fears of an unsustainable strain on cash reserves if this relationship were to continue throughout 2023. While margins as of this quarter do remain in negativity, the indication that manufacturer's price rises are starting to translate, finally, into improving margins bodes well and may prove to steer the industry away from finding itself in a critical liquidity crunch.

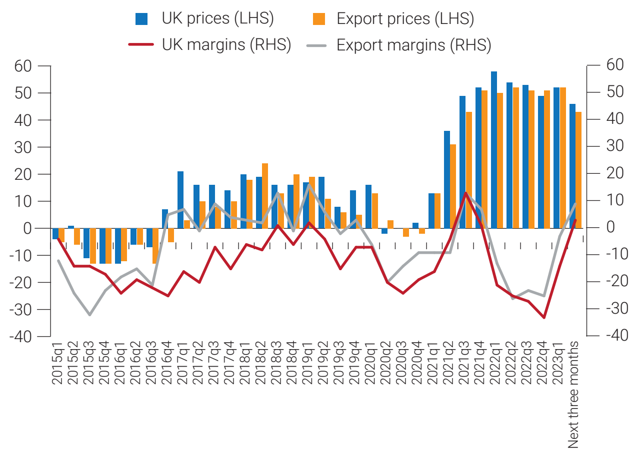
Demand, as measured by our orders metric, has improved this quarter. This gives the industry the capacity in the coming quarter to improve its margins through increased volume, as long as input cost inflation stays its expected course in the next three months. Last quarter's data indicated a period of 'stagflation', that is, a period where inflation continues to propagate, but little to no growth is seen in the industry's orders and output. For now, it looks like that any stagflation-like effects seen last year has not spilled over to 2023.

The balance figures for UK prices and Export prices are both +52%, which is a slight increase on the previous quarter where they reported at +49% and +51% respectively. The balance figure for UK margins and Export margins are -14% and -3% respectively. The solace lies in the next-quarter expectations from manufacturers for margins performance, which come in positively at +3% and +9% respectively. While still only in single digit positivity, if these expectations come to pass, then this will signal the first time margins have entered positivity for the past five quarters.

Recent ONS data shows that the rate of increase of input prices are cooling but remain in double digits, with the latest Producer Price Inflation (PPI) figure standing at 14.1% on the year to January, down from the highs observed around July 2022 at approximately 24%[2].

Inflation persists but margins show signs of recovery

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑	52%	NEXT THREE MONTHS	↓	46%
EXPORT PRICES	PAST THREE MONTHS	↑	52%	NEXT THREE MONTHS	↓	43%
UK MARGINS	PAST THREE MONTHS	↑	-14%	NEXT THREE MONTHS	↑	3%
EXPORT MARGINS	PAST THREE MONTHS	↑	-3%	NEXT THREE MONTHS	↑	9%

Export prices of intermediate goods increasing

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

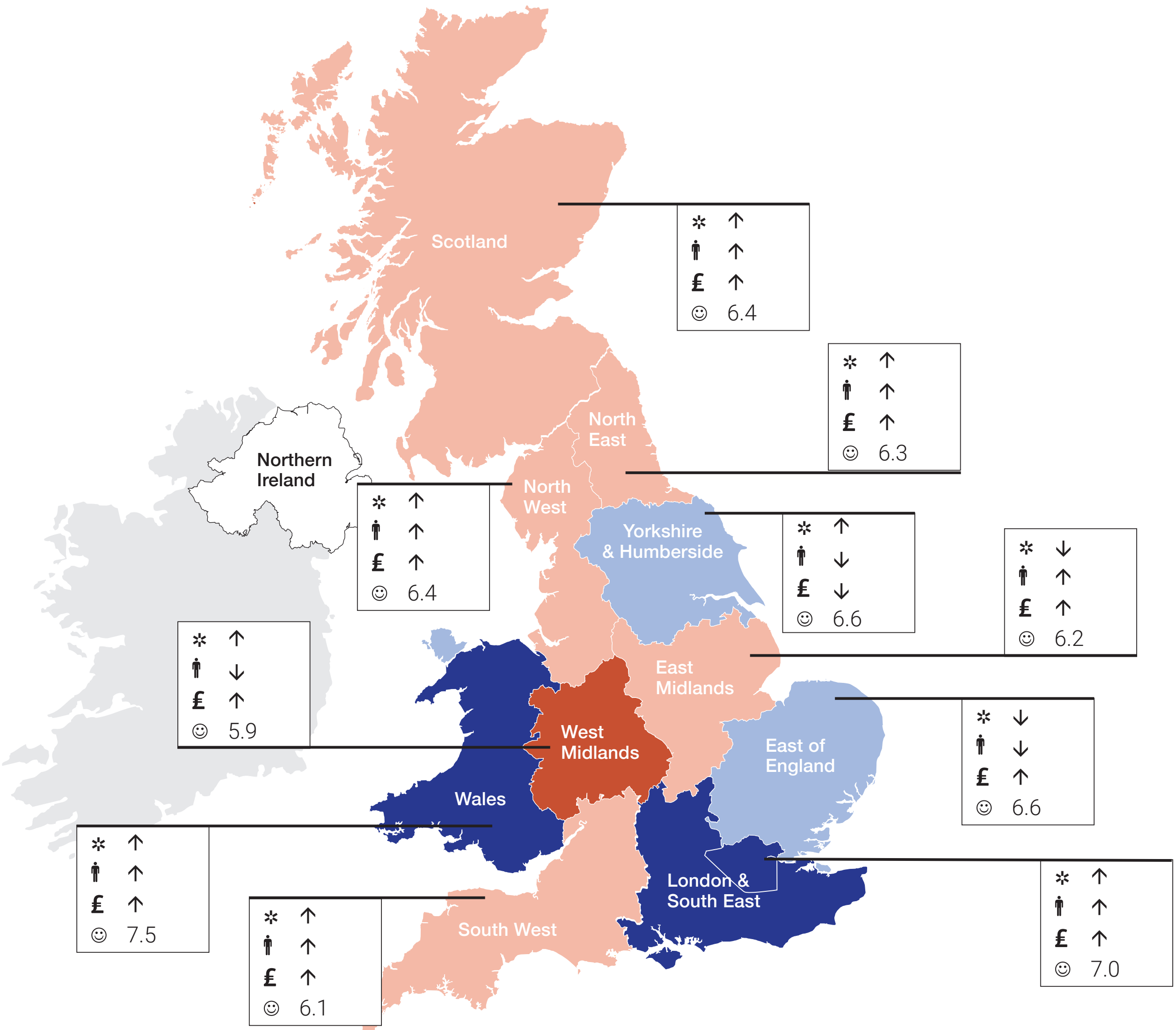
Source: Make UK Manufacturing Outlook Survey

[2] ONS Producer price inflation data, published 15th February 2023, accessed 3rd March 2023.

NATIONAL & REGIONAL

Manufacturer's confidence improved at the start of this year in our Q1 *Manufacturing Outlook* report alongside improvements in output and orders. Optimism in both business conditions and the economic environment improved following a series of declines in a surprise turn of events.

Although there remain differences amongst parts of the UK, most manufacturers feel more positive about the next 12 months as businesses restart their investment plans. However, it remains to be seen whether this newfound confidence is just a blip in the series or the beginnings of a period of growth.



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, this quarter all regions and nations reported positive business confidence (above the '5' inflexion point), which indicates on average the share of manufacturers who believe the next 12 months will be better than those that feel conditions will be worse has increased. This is despite consecutive quarters of contractions last year.

The change in sentiment is reflective of the positive performance of the manufacturing sector on output, orders, employment, and investment this quarter. For example, in comparison to Q4 2022 only Yorkshire & the Humber reported a lower balance for investment intentions this quarter whilst all others reported an improved investment outlook.

Similarly, most regions and nations reported an improved performance on output compared to the previous quarter except for the East Midlands and East of England where the balances for output volumes growth declined. As was often the case pre-pandemic, the South East & London has returned to the top of the charts on business confidence across England, whilst Wales reported the highest business confidence in the UK.

Headline business confidence reported at 6.45, an increase of 0.73 from Q3 2022.

The largest improvement in business confidence was reported by Wales, which increased by 2.9 points to 7.50, making these manufacturers the most confident in the UK. Wales is followed by the East Midlands and Scotland as the second and third most improved in business confidence, respectively.

Only the West Midlands reported a small decline in confidence but even manufacturers here on average remain above the '5' inflexion point. As a result of this decline the West Midlands is, compared to the rest of the UK, the least confident in business conditions. These manufacturers are followed by the South West and East Midlands as comparatively the least confident regions in the UK, despite the latter region improving significantly from last quarter.

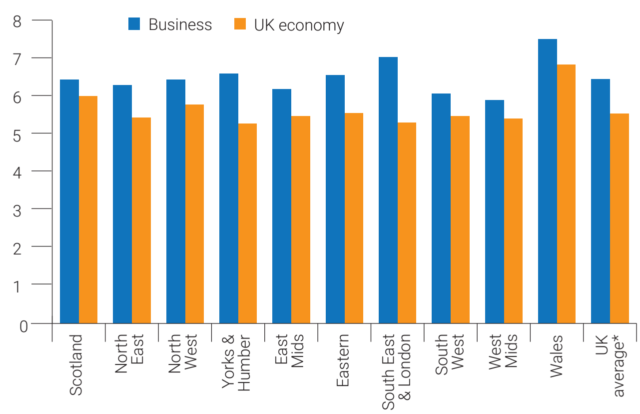
Despite the differences among locations in the UK, manufacturers are more positive about the future than they are negative on the ten-point scale that measures optimism. Though this is a welcome position for the manufacturing community, it is worth keeping note that confidence remains a volatile metric that does not necessarily correlate to actual quarterly performance.

UK ECONOMY CONFIDENCE

Manufacturer's views of the overall UK economy improved to 5.54, following business's confidence in economic conditions falling into negative territory last quarter. The change in UK economy confidence may reflect the media stories that suggest the UK could avoid a recession this year, alongside growing order books and easing supply-chain disruption which have given manufacturers more reason to be optimistic about the future.

Confidence improves for most manufacturers

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	20	42	27	24	15	30
North East	29	29	57	17	0	33
North West	17	13	22	13	17	35
Yorks & Humber	18	50	23	41	0	29
East Mids	6	6	-13	6	29	13
Eastern	-5	20	15	20	10	35
South East & London	12	39	33	27	9	31
South West	33	47	13	27	7	27
West Mids	17	0	34	3	-3	14
Wales	17	0	17	17	17	50

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

Despite the International Monetary Fund's (IMF) forecasts indicating that the UK could be the worst performing country on GDP growth amongst the G7 in 2023, the nation narrowly avoided a technical recession towards the end of last year.

However, this quarter's survey results on manufacturing activity could indicate that current UK forecasts are on the downside but due to many of last year's challenges spilling over to the current year it is not yet possible to revise forecasts upwards yet.

According to current predictions set by Oxford Economics, most major developed and emerging economies expect to achieve positive GDP growth this year, except for Germany forecasting a GDP growth rate of -0.6%. Unsurprisingly, only China and India forecast growth to exceed 2%, whilst the rest of the developed world mainly predict anaemic growth rates.

Nevertheless, a return to positive growth expectations for the global economy will benefit the UK, particularly manufacturers whose exports account for over half of the UK's total exports annually. However, monthly trade statistics collected by the Office of National Statistics (ONS) have been indicating shifting trends in trade activity between the UK and the rest of the world. In the final quarter of 2022, the goods trade deficit stood at £64bn.

Across the year the trade deficit increased by £85bn reaching £108bn in 2022 indicating we are importing significantly more than we are exporting. However, the data is highly influenced by inflation rates overseas, and a weaker Sterling value that has contributed to more expensive imports, even if the volume of imports did not change dramatically since 2021.

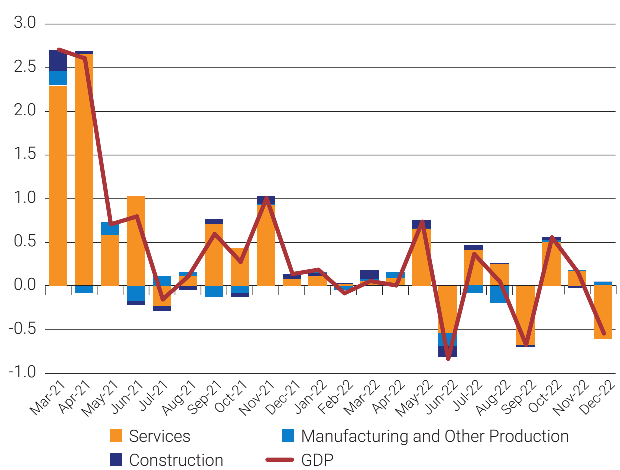
Monthly trade statistics reveal that trade patterns have continued to shift slowly since the UK's exit from the European Union (EU) too. More manufacturers are exporting to non-EU countries, such as the US and China, however, our reliance on the EU for imported goods has similarly been increasing in that time indicating that Europe continues to be a major partner for many manufacturers.

It's not clear how the replacement of the NI Protocol with the "Windsor Framework" will change current trade patterns. The new deal agreed between the UK and EU agrees to eliminate customs and regulatory checks on most goods traded between Great Britain (GB) and Northern Ireland, as long as they are certified as not intended for the EU market. The deal will be welcome to many businesses, particularly manufacturers based in the Republic of Ireland that trade extensively with Northern Ireland. However, the new deal also means that goods inspections would be taking place at Northern Ireland ports increasing costs for the UK, many arguing that the deal puts the UK at a competitive disadvantage.

Nevertheless, inflationary pressures are expected to ease this year with world consumer inflation rates expected to be around 5.4%, lower than 2022's 7.8% inflation. UK national statistics recently reported CPI inflation at 10.1% for the 12 months ending January 2023, down from 10.5% on the previous month. Much of this downward pressure on prices originated from falling fuel costs, but many consumer goods continue to experience high inflation rates. For example, food & drink price inflation currently stands at 16.8% which continues to weaken household spending power.

UK GDP contracted in December 2022 despite escaping a technical recession in Q4

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



Source: ONS

This quarter's Manufacturing Outlook survey results continue to indicate that manufacturers are still raising prices as they look to recover lost margins. Producer inflation, or the price of inputs for businesses, is currently at 14.1% for the 12 months ending January 2023, down from 16.2% in December 2022. Whilst falling fuel prices are also benefiting manufacturers, the inflated cost of raw materials remains an issue, particularly metals, non-metallic minerals, as well as other parts and equipment. However, as the rate of inflation is exhibiting a downward trend there is hope that manufacturers will be able to manage costs better this year.

This is of course dependent on how energy prices evolve this year. The generous Energy Bills Relief Scheme (EBRS) is due to expire and be replaced with the Energy Bills Discount Scheme (EBDS) from April 1st which will worry manufacturers as the novel support is significantly less generous, particularly for those businesses that do not qualify for the Energy and Trade Intensive Industry (ETII) category. However, as wholesale prices for gas and electricity are falling the scheme is unlikely to ever trigger for many, despite prices still being 3-4 times greater than they were pre-pandemic. Many manufacturers are now investing in renewables and onsite generation to mitigate these costs, but they are unlikely to solve cashflow challenges in the short term.

In addition to energy costs, manufacturers will continue to grapple with labour and skill shortages in 2023. Although vacancies are on the decline, businesses remain keen to bolster their workforce. In manufacturing, the issue of labour shortages is particularly acute due to an increase in early retirement and people leaving the workforce for health issues. There is a huge concern that the manufacturing workforce will continue to decline, with more than half of manufacturers expecting 6-20% of their workforce to retire within the next 10 years, according to Make UK survey data.

UK Economic Forecasts

% change except where stated

	2022	2023	2024
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.14	1.14
Exchange rate ($/£)	1.2	1.24	1.26
Exports	10.3	1.4	3.3
Imports	12.6	2.6	3.0
Current account (% GDP)	-4.7	-3.8	-3.5
OUTPUT			
Manufacturing	-4.8	-3.3	0.9
GDP	4.0	-0.4	1.5
COSTS AND PRICES			
Average earnings	6.0	5.3	3.2
Oil price (Brent Oil $/bl)	100.8	86	84
EMPLOYMENT			
Manufacturing (000s)	2,628	2,598	2,551
Rest of economy (000s)	36,046	35,760	35,942
Unemployment rate (%)	3.7	4.2	4.3

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

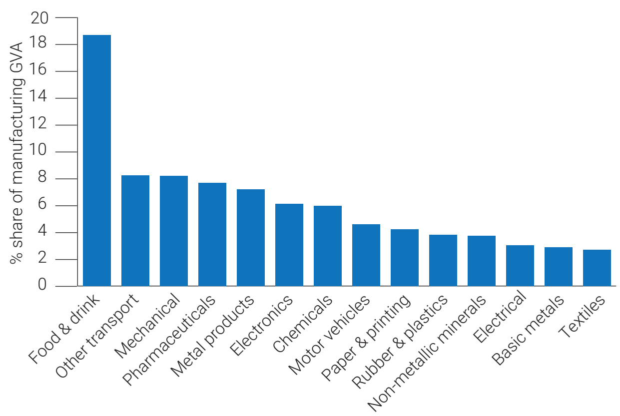
	GDP			INFLATION		
	2022	2023	2024	2022	2023	2024
US	2.1	0.0	0.8	4.7	4.4	2.6
Eurozone	3.5	0.4	1.5	20.2	14.6	9.4
France	2.6	0.5	1.2	1.6	5.2	1.0
Germany	1.9	-0.2	1.7	3.1	4.7	0.1
Japan	1.3	0.7	1.3	-0.2	1.5	0.3
China	3.0	4.5	4.7	0.9	2.4	2.4
India	6.9	4.8	6.8	5.1	5.4	4.1
World (2015 PPPs)	3.1	1.5	2.6	7.8	5.4	3.2

Source: Oxford Economics

SECTOR FORECASTING 23Q1

Q1 2023 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: ONS

FOOD & DRINK

As the UK's biggest subsector in terms of Gross Value Added (GVA), the **Food & Drink** subsector has the largest influence on overall UK manufacturing performance. The total proportion of manufacturing GVA that the Food & Drink subsector accounts for has declined a little since the last quarter, now comprising 18.7% of all UK manufacturing gross value added. While the output forecast for the subsector is negative at -2.4% for 2023, it fares better than the UK manufacturing average output forecast of -3.3%. The forecast for 2024 expects the subsector to return to growth at 1.8%. Employment, on the other hand, is forecast to decline in the subsector by approximately a percentage point faster than the average, at -2%. A continued contraction is expected in 2024 with a further decline in employment by -1.1%.

ELECTRONICS

The **Electronics** subsector has a larger than average decline expected in its output forecast for 2023 at -5.1% but is expected to return to growth in 2024 with a growth rate of 1.2%. Decline in the subsector's headcount is also outpacing the manufacturing average as a contraction of -3.6% is expected, with that decline continuing into 2024 with a further -2.3% decline forecast. However, our latest survey results indicate that the performance of Electronics manufacturers may be improving so it is possible that current forecast for the industry is weighted to the downside.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector has the most negative 2023 forecast for output out of all manufacturing subsectors. This pessimistic view for output is being driven by energy intensive processes that disproportionately impact these industries. Because of this, these manufacturers are more exposed to elevated energy costs. The output forecast for 2023 stands at -10.2%, approximately thrice the average rate of output decline compared to the wider manufacturing sector. This output decline is forecast to continue into 2024 where a further output contraction of -6.7% is expected. Employment is also forecast to follow suit, albeit to a lesser degree, with a contraction in headcount by -6.6% expected in 2023 and -4.7% in 2024.

While the **Fabricated Metals** subsector usually sees its performance closely linked to the Basic Metals subsector, forecasts are notably less negative for 2023. The expected decline in output for 2023 is -4.8%, which is over twice as less severe than the decline seen in the Basic Metals subsector. Fortunately, the forecast for output in 2024 returns to positivity, with an expansion in output by 2.8% expected. The employment forecast for the subsector in 2023 follows that of the UK manufacturing average with a decline of -1.3% expected. Additionally, 2024's forecast for employment sees a small return to growth, by 0.5%.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector expects one of the more negative output forecasts out of UK manufacturing, with a decline in output for 2023 by -7.5% forecast, which is a little over twice as negative as the average. However, the 2024 forecast for output is less negative at -1.1%. This subsector produces goods that supply plant & machinery for the wider manufacturing sector, so its decline is concerning for investment activity. Employment, conversely, is forecast to grow in this time, by 1.5% in 2023, but then to fall again in 2024 by -2.9%.

TEXTILES

The **Textiles** subsector is set to decline in output this year by just over twice the average rate of decline at -7.1%. However, it should be noted that in 2021, this subsector saw the most significant growth in output out of all manufacturing subsectors that year, so this forecast decline comes on top of previously high figures. The forecast for the subsector's output in 2024 stands at -1.6%. Employment is forecast to decline consecutively both in 2023 and 2024, by -4.4% and -3.2% respectively.

PAPER & PRINTING

The **Paper & Printing** subsector holds the second most negative output forecast for 2023 this quarter, with a decline of -8.7% forecast. This is significantly more negative than the UK manufacturing average output forecast for 2023 as demand for paper products falls. However, the subsector expects to return to growth with an expansion in output of 1.9% forecast in 2024. Employment is set to decline across both 2023 and 2024, by -3.1% and -2.2% respectively.

ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector suffered the steepest decline in output in 2022 out of all UK manufacturing subsectors by -12.4%. With the current forecast for 2023, this trend is set to continue with a continued decline in output by -8% forecast. The rate of output decline is expected to almost completely cease in 2024, where the output forecast is a moderate -0.2%. Despite expecting a contraction this year, this subsector is forecasting employment to grow quickly, by 14.8% in 2023 and almost 1% in 2024 which suggests the subsector may be preparing for future growth. This significant growth forecast for employment is likely associated with either a singular, or small group, of large projects which is causing forecasters to predict such a boom in the sector's headcount over such a short period.

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. The subsector's output forecast fares more positively than the average for 2023 yet still expects to contract by -1.3%. However, next year the subsector can currently expect to grow by 0.9%. Employment growth in the subsector is expected to remain roughly flat this year, with only 0.2% growth forecast. Next year the subsector's forecast headcount to decline by -1.4%, which is close to the manufacturing sector's average for 2024.

PHARMACEUTICALS

The **Pharmaceuticals** subsector continues to provide trend-bucking forecasts. The subsector saw consecutive counter-trend forecasts throughout the pandemic and continues to do so even now. With a 2023 output growth forecast of 9.2%, this subsector has the largest output growth forecast out of any manufacturing subsector for the year. In comparison, 2024's expectation is more sober, at 1%. Reflecting this significant expected growth in output, 2023's employment forecast is also positive, at 4.3% but the subsector could expect to decline -5.4% next year if current trends continue.

CHEMICALS

The **Chemicals** subsector, having followed the performance of the Pharmaceuticals in previous years, does not look set to do so in current forecasts. The subsector forecast output to decline by -6% this year, about twice as negative as the manufacturing average. This may partially be related to energy usage in the subsector, but most chemical manufacturers will be protected by the Energy & Trade Intensive Industry (ETII) category of the new Government energy support scheme. In addition, uncertainties on EU regulation, specifically on REACH, could be having an impact on output levels. The 2024 forecast is roundly flat, with only a small growth of 0.4% expected. Employment is also set to decline by -6.2% this year and by a further -4.5% in 2024.

RUBBER & PLASTICS

The **Rubber & Plastics** subsector is set for an output decline in 2023 slightly beyond that of average, with a decline of -5.6% forecast. However, next year the subsector's rate of decline should stabilise towards zero as only -0.7% is forecast. On the other hand, the employment forecast bucks the negative trend seen across the UK average in 2023, with growth in headcount expected by 2.5%. This is repeated in 2024 with another 2.5% increase in employment forecast.

MOTOR VEHICLES (AUTOMOTIVE)

Having seen the second largest decline in output in 2022, the **Motor Vehicles** subsector is forecast to return to growth in 2023, bucking the negative trend observed in the wider manufacturing industry. 1.9% growth is expected in the subsector's output, which is also expected to grow by an even more positive 4.4% in 2024. Employment sees a marginally negative forecast for 2023 by -0.9%, with a more significant decline by -4.1% forecast for 2024.

OTHER TRANSPORT

The **Other Transport** subsector, which is comprised of aerospace, defence, shipping, and rail industries, has a roundly flat forecast for output growth in 2023, at only 0.3%. However, this in and of itself is positive when compared to the UK manufacturing average output forecast for 2023 which stands at -3.3%. The output forecast for 2024 is more positive, at 2%, which is also approximately twice as positive as the wider sector's prospects. Employment is set to grow marginally, by 0.9% in 2023, but decline in 2024 by -1.3%.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2022	2023	2024	2022	2023	2024
Basic metals	1.4	-10.2	-6.7	3.0	-6.6	-4.7
Metal products	-11.1	-4.8	2.8	0.8	-1.3	0.5
Mechanical	-10.3	-7.5	-1.1	1.4	1.5	-2.9
Electronics	-5.9	-5.1	1.2	1.5	-3.6	-2.3
Electrical	-12.4	-8.0	-0.2	6.1	14.8	0.6
Motor vehicles	-12.0	1.9	4.4	0.3	-0.9	-4.1
Other transport	-4.7	0.3	2.0	2.8	0.9	-1.3
Food & drink	0.5	-2.4	1.8	0.4	-2.0	-1.1
Chemicals	-5.5	-6.0	0.4	4.0	-6.2	-4.5
Pharmaceuticals	-3.3	9.2	1.0	7.0	4.3	-5.4
Rubber and plastics	-9.7	-5.6	-0.7	4.7	2.5	2.5
Non-metallic minerals	3.1	-1.3	0.9	2.7	0.2	-1.4
Paper and printing	-5.7	-8.7	1.9	3.2	-3.1	-2.2
Textiles	-3.3	-7.1	-1.6	7.9	-4.4	-3.2
Manufacturing	-4.8	-3.3	0.9	3.4	-1.2	-1.8

Source: Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

FROM STRESS TO VALUE REALISATION: IMPLEMENTING A SUCCESSFUL BUSINESS TURNAROUND

Following a series of declines throughout 2022, UK manufacturers have entered 2023 in a stronger position than many expected.

Our survey indicators show that confidence is returning to business, with output and orders rebounding, recruitment remaining strong and investment intentions increasing.

However, against this backdrop we found levels of distress in the sector to have increased during 2022. This, in part, may be due to the withdrawal of Government measures put in place during the pandemic. This has been compounded by the challenging headwinds many have faced in the sector.

In our experience, where business start to show the signs of stress, proactive management teams identify this early and create the time to assess, prioritise, plan and implement turnaround strategies, especially where difficult decisions are required.

WHAT DOES THE EVIDENCE SHOW?

A useful barometer for the current levels of distress in the sector are the corporate insolvency statistics.

Our analysis of insolvency data back to 2007 shows that 2021 represents the lowest level of insolvencies in the manufacturing sector over that 14 year period. Distress and insolvencies were artificially supressed by the Government measures put in place during the pandemic. However, the unwinding of these provisions during 2022 led to a dramatic increase in insolvencies in the year, with manufacturing insolvencies being 66% higher than in 2021, and at levels not seen since 2012.

In our opinion, given the prevailing headwinds, there is significant risk of many more manufacturers becoming stressed or distressed during 2023 and management teams will need to be focussed on turnaround planning and implementation.

WHAT ARE THE AREAS OF FOCUS FOR A TURNAROUND PLAN?

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

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

SUCCESSFUL TURNAROUND REQUIRES PROACTIVE FOCUS

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

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

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

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

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

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

The Manufacturers' Organisation

IDEAS | PEOPLE | TRUST

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

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

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

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

Makeuk.org

To find out more about this report, contact:

Fhaheen Khan
Senior Economist
fkhan@Makeuk.org

James Brougham
Senior Economist
jbrougham@Makeuk.org

Seamus Nevin
Chief Economist
snevin@makeuk.org

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

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

Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,700 offices in 164 countries. We operate from 18 offices across the UK, employing 7,070 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 accountancy, tax and business advice to patent box and research and development claims and M&A opportunities to help our clients grow in the UK and overseas. We also provide manufacturing businesses and organisations with robust, independent audits.

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

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

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

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

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

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

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