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MAKE uk
The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2020 QUARTER 3

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FOREWORD

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For centuries stories have helped shape the beliefs, behaviour and choices humans make on a daily basis. Indeed, the power of stories has even been used to explain the causes of the 2008-2009 financial crisis, as an aggregation of blind faith in ever-rising house prices led to the devastating collapse of mortgage backed securities. Amongst economists, that ethereal force is labelled as "Animal Spirits", a term first coined by John Maynard Keynes in 1936. Traditionally, Animal Spirits are used to explain deviations in financial markets that could not easily be explained by rational consumer choice.

In today's markets stories can influence policy too, and the unprecedented pandemic certainly resulted in a stampede of stories that impacted the development of policies as consumer confidence collapsed.

The start of the decade promised a story of confidence and renewed investment, as reported in previous Make UK surveys, which indicated an encouraging start to 2020 and meant that manufacturers were finally ready to start investing in productivity enhancing technologies. At the time, the novel coronavirus, later dubbed COVID-19, was still an unknown entity sweeping across the East Asian markets, seemingly posing little economic threat to western shores.

A few months down the line and the virus had successfully engulfed the global community, impacting our daily lives in ways that seemed unimaginable this time last year. At the time of writing, the virus had unfortunately already claimed over 900,000 lives across the globe.

In a bid to stop the spread of COVID-19 most countries enacted policies that, in simple terms, shut down economies in order to reduce physical contact between citizens. It was these policies, combined with the stories spread by official news outlets, social media and word-of-mouth that set alight our inner animal spirits and played an important role in encouraging compliance of social distancing. As well as the story of mass bankruptcies and unemployment that led to unprecedented Government interventions.

Although the worst of the public health impact will have been mitigated, the nation is now faced with its deepest recession in recent history. In Q2 2020, the UK reported the biggest quarterly contraction in GDP since records began in 1955.

Make UK's latest Manufacturing Outlook, in partnership with BDO, reported some sobering yet ultimately bleak results for UK manufacturing performance. The UK's leading barometer of manufacturing activity indicates output and order levels remain at historically low levels, although they have improved markedly following record-breaking falls during the second quarter of 2020.

Export performance has ticked up slightly more so than domestic orders, as overseas markets reopen their doors faster than UK businesses. Domestic selling prices have remained flat, whilst export selling prices have declined since the last quarter with margins improving somewhat overseas too. Remarkably, this quarter, more Make UK members than usually expected have reported market conditions improving in Asia faster than in North America. Although, the story of the European Union being the biggest market for manufacturers remains true even in the latest edition.

Despite the Job Retention Scheme, the latest set of data reveals manufacturers are going ahead with plans to cut staff. Albeit, the data varies for different subsectors in manufacturing. The primary concern for Government will now be how the impending job losses are managed following the end of the scheme in October. Equally concerning is a further contraction to investment intentions which has reported a negative balance for consecutive quarters for the first time since late 2015.

As we approach the final quarter of 2020, industry professionals and Government servants alike have been working tirelessly to carve the path forward for the UK's recovery. The correct path is not so clear, yet now more than ever, a story that favours investment in digital technologies with a focus on going beyond net-zero and evolving the skillset of the work force will be core to the revitalisation of both the UK manufacturing sector and the wider economy.

HEADLINES

Make UK's Q3 2020 *Manufacturing Outlook* report, in partnership with BDO, contains the follow-up to some of the worst results ever witnessed within the survey since 1998, courtesy of COVID-19.

The latest results indicate that manufacturers are still faring poorly in the current economic climate, but that performance in comparison to last quarter is greatly improved. Still, the numbers on output, orders, employment and investment remain amongst the worst results observed on record.

As the UK enters a period of recovery, the latest survey reported a better than predicted output balance of -36%. Promisingly, UK manufacturers forecast the trend towards growth to continue over the next quarter.

The investment intentions balance also worsened to -32%. As the UK endeavours to reinvigorate itself on the global stage it is concerning that manufacturers either fear, or are unable to invest in new technologies. Manufacturers are aware that the next critical step in the sector's evolution is to promote the adoption of new technologies, coupled with a skills revolution.

UK prices improved, whilst domestic margins moved in the opposite direction. Export prices and margins reported the reverse results, indicating that manufacturers are reducing prices to increase sales overseas due to a lack of domestic demand.

Confidence has become more positive since Q2 with improvements experienced across all regions.

INDICATOR	BALANCE	CHANGE	
Confidence	5.54	↑	Business confidence increased across all regions
Output	-36%	↑	Output balance improved but remains very negative
UK orders	-36%	↑	UK orders improved but remains very negative
Export orders	-34%	↑	Export orders improved but remains very negative
Employment	-29%	↓	Firms continue to cut jobs despite the furlough scheme
Investment	-32%	↓	Investment intentions declines further

Source: Make UK Manufacturing Outlook Survey

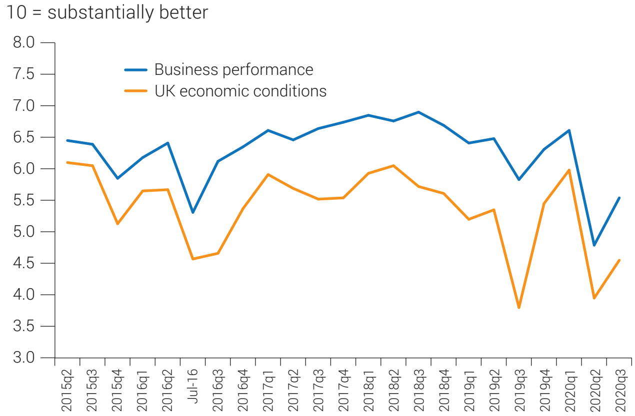
UK orders have been negative since the aftermath of uncertainty from multiple EU exit deadlines. Following the abysmal results of last quarter, the UK order balance improved in line with the output balance to -36%. The export order balance followed suit to -34%. Although these figures indicate an overall contraction in the industry, they are more positive than last quarter meaning that a larger proportion of the industry's performance either improved or did not worsen.

Encouragingly, that trend is expected to continue going forward and this is also reflected in the latest results for business confidence too. However, the data evidences against a quick V-shape recovery for manufacturing.

The employment balance reported a worse -29%, in line with redundancy expectations revealed in other Make UK surveys. Interestingly, as output and order levels improve, UK manufacturers are still cutting back on staff. Whether this is a sign that firms are adapting to the new trading environment by increasing productivity with a smaller workforce remains to be seen.

Confidence picking up following Q2 crash

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



Source: Make UK Manufacturing Outlook Survey

OUTPUT

Make UK's previous *Manufacturing Outlook* survey reported the lowest balance of output since 1998. At -56% for Q2 2020 the impact of COVID-19 outweighed the disaster of even the Global Financial Crisis, which reported an output balance of -52% at its worst point in Q2 2009. Although the output balances for these two events are similar, the key difference between them is the speed of collapse whereby the 2008-2009 crisis reported a relatively slower decline over time. In contrast, the silent tsunami that is the pandemic hit UK manufacturing with greater force in a shorter space of time.

This quarter's survey covers a portion of the period of total lockdown during the month of May, during which many manufacturers continued to operate but witnessed orders dissipate regardless. Moreover, the survey period also includes the months where lockdown restrictions were eased in the UK, as well as overseas. Hence, partial activity returned during this time.

expect a slower recovery than other data sources have suggested.

The latest survey reports similar trends for individual subsectors, albeit the results remain mixed.

Basic Metals reported a shockingly worse -75% output balance, following last quarter's -5%.

Metal Products output balance improved to -19% from -48%. As activity returns to a number of key downstream sectors, such as Automotive and Construction, it is expected these subsectors will see some further recovery.

The mechanical subsectors such as Machinery Equipment, Electrical Equipment and Electronics all reported an improvement in the output balance similar to the UK average. However, all remain in negative territory indicating a lack of demand for advanced technologies and capital investment. Nevertheless, forecasts for the next three months are generally more positive.

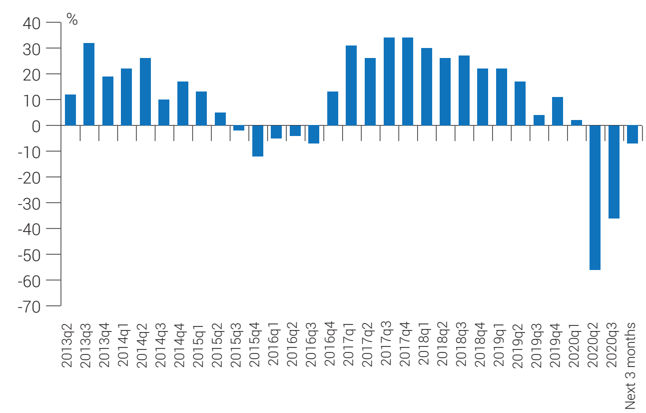
PAST THREE MONTHS	↑	-36%	NEXT THREE MONTHS	↑	-7%

As such, the latest *Manufacturing Outlook* survey for Q3 2020 reported an output balance of -36%, a sharp improvement on its predecessor but still low by historical standards.

However, positively Make UK members expect the industry to continue moving in an upwards direction over the next three months. Although the forecast for the next quarter is still negative at -7%, the result indicates that manufacturers

Output trending up but maintains a negative balance

% balance of change in output



Source: Make UK Manufacturing Outlook Survey

Rubber and Plastics also reported an improved balance of -15% this quarter. Although on balance negative, this sector has observed mixed outcomes. Rubber firms continue to struggle as a result of weak demand from key intermediate sectors. Whilst plastic goods have seen an increase in output thanks to PPE production and plastic packaging.

Output summary

% balance of change

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals	-75%	-31%
Metal Products	-19%	-16%
Mechanical	-44%	4%
Electronics	-28%	0%
Electrical	-44%	-19%
Rubber & Plastics	-15%	5%
TURNOVER		
£0-9m	-33%	-8%
£10-24m	-20%	5%
£25m and over	-33%	19%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The previous *Manufacturing Outlook* publication reported historically low balances for all measures of orders. The total orders balance reported at -53% whilst both the domestic and export order balances reported at -52%. The unfortunate results highlighted by that survey were a reflection of the dire impact COVID-19 had on markets across the globe – particularly via the disruption of supply chains and limited access to logistic capacity.

The latest total order balance reported at -40%, an improved yet still fragile result.

UK ORDERS

UK orders improved to -36% this quarter. The result indicates on balance a smaller portion of manufacturers experienced a worsening of domestic orders over the last three months.

However, as key downstream sectors restart production this demand will be expected to return over time. The latest results indicate that this has already taken place to some extent, and the same manufacturers forecast the order balance will improve again in the next quarter.

UK ORDERS	PAST THREE MONTHS	↑	-36%	NEXT THREE MONTHS	↑	-6%
EXPORT ORDERS	PAST THREE MONTHS	↑	-34%	NEXT THREE MONTHS	↑	-4%
TOTAL ORDERS	PAST THREE MONTHS	↑	-40%	NEXT THREE MONTHS	↑	-4%

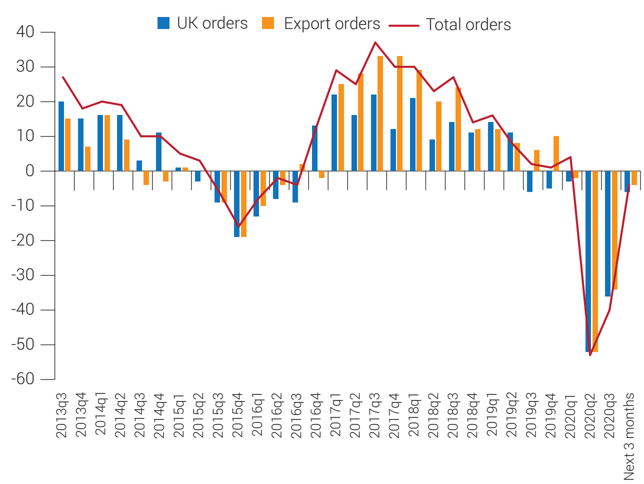
Over the next three months manufacturers expect the upward trend to continue. Although these forecasts are still negative, it is also true that the majority of manufacturers equally underestimated their predictions last quarter too. As a result the latest balances for Q3 2020 have been more positive than what was predicted in our Q2 2020 survey, and firms would be hopeful of a continuation of this trend.

Nevertheless, the remaining months of 2020 will be critical to the UK's recovery as negotiations with the EU, as well as other countries, continue to progress with little information of what the state of trade will be in 2021. Given UK orders have reported negative balances since Q3 2019, many UK manufacturers now prefer to divert their attention to overseas markets in order to grow their business. Certainly, in the latest survey the performance of export orders has been marginally better than UK orders as international markets reopened. However, the emerging second wave of infections across European markets poses a threat to businesses overseas too.

As reported in the data for output, the latest survey reported mixed results for UK orders across the industry.

Orders reported a slight recovery for Q3

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

Basic Metals reported a staggeringly low balance of -88% with expectations for below average improvement of -38% over the next three months. A combination of uncertainty with trade negotiations, weak demand from aerospace and construction sectors, and vulnerabilities amongst SME businesses have inevitably impacted the UK Metal subsectors. In contrast, Metal Products —which includes firms within fabricated metals – improved on its performance last quarter.

Both Mechanical Equipment and Electronics reported improved balances of -35% and -29% respectively. However, the Electrical Equipment subsector, which includes firms that produce goods such as fibre optic wirings, declined to -82%. Finally, Rubber & Plastics reported a worse -20% balance.

EXPORT ORDERS

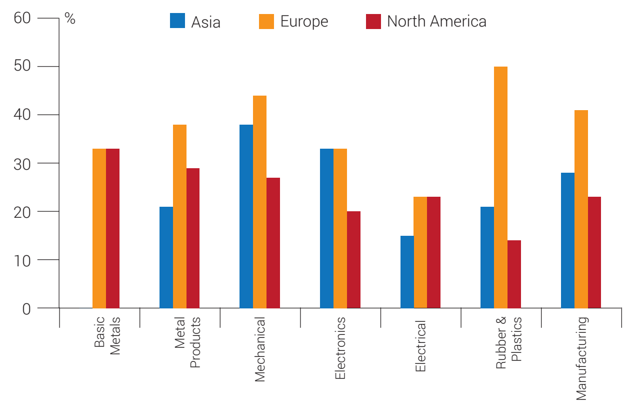
Export orders reported a balance of -34%, a marked improvement on Q2 2020's -52%.

Regardless of how trade negotiations progress, the COVID-19 pandemic has undoubtedly raised concerns of trade weaknesses that do not pertain to Free Trade Agreements (FTAs). This includes disruptions to the flow of goods through supply chains as a result of losing access to key components that may appear small to the naked eye but are critical to the completion of finished goods. For example, during the early days of the pandemic the automotive sector demonstrated these issues as OEMs were unable to source components from China.

As expected the EU remained the top market for the UK this quarter. Interestingly, manufacturers reported improved demand conditions in Asia more so than in North America. This is primarily a reflection of the different stages of markets reopenings across the globe as eastern markets reduced lockdown restrictions earlier than western markets.

Asia overtakes North America as the market of opportunity

% 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	-88%	-38%	-93%	-50%	-88%	-31%
Metal Products	-15%	-6%	-30%	-19%	-30%	-8%
Mechanical	-35%	1%	-34%	16%	-35%	6%
Electronics	-29%	-12%	-25%	-21%	-31%	-17%
Electrical	-82%	-6%	-50%	0%	-82%	-6%
Rubber & Plastics	-20%	17%	-47%	-18%	-25%	-10%
TURNOVER						
£0-9m	-38%	-12%	-46%	-14%	-45%	-9%
£10-24m	-15%	10%	-21%	13%	-6%	8%
£25m and over	-29%	22%	-33%	5%	-30%	24%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

The Government's Job Retention Scheme (JRS) has been perhaps the most lauded of the measures introduced to mitigate the economic impacts of the COVID-19 pandemic on the country. Now in the third quarter of the year, and as the scheme's end looms, redundancies have been soaring, and the rate is only expected to get worse. It is certain that if it was not for the JRS, redundancies in the second quarter of this year would have been exceptionally higher than they have been.

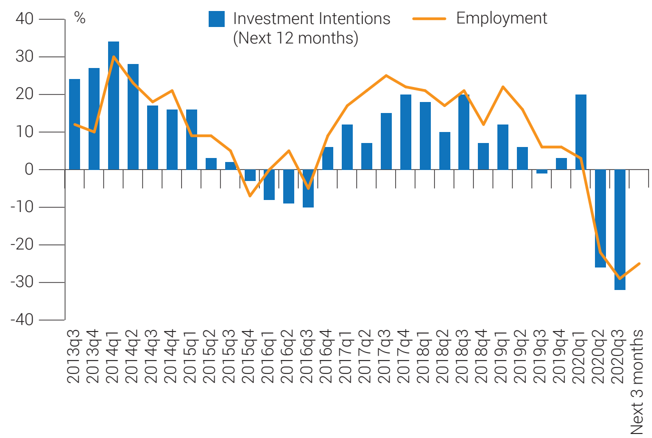
Nevertheless, we are now witnessing manufacturing businesses increase their levels of redundancies even before the furlough scheme has fully wound up. In many cases this is being done as these manufacturers have now struggled through the most constraining time of the lockdown period, and have embarked upon new business and process plans that inevitably included efforts to reduce the company's wage bill. With already strained cashflow, manufacturers are moving into a damage-control process, attempting to keep production levels as high as feasible with a reduced headcount.

As such, this quarter's research shows that the balance of change figure for employment within the manufacturing industry is lower than that of last quarter. Yet more concerning, particularly for those with jobs in the industry, is that manufacturers' future expectations for employment in the final quarter of this year are still deeply negative, warning of a continued bleed of jobs in the sector for the rest of the year.

Investment intentions have continued to remain victim to manufacturers' attempts to redirect capital towards immediate business continuity. Even though the uptake of Government backed loans such as CBILS was high, many businesses are holding this debt unsustainably, and so it has not loosened manufacturers' purse strings to a sufficient degree to have allowed them to commit any funds towards capital expenditure. As the UK economy takes its first steps towards recovery, in this third quarter of the year, our research shows that investment intentions are in fact even more negative than they were in the second quarter. Such subdued investment intentions, especially if continued throughout this year and into 2021, will start eating further into the UK manufacturing industry's global competitiveness.

Investment and employment intentions fall even deeper into negativity

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS ↓	-29%	NEXT THREE MONTHS ↑	-25%
INVESTMENT	NEXT TWELVE MONTHS ↓	-32%		

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	**PAST THREE MONTHS**	**NEXT THREE MONTHS**	**NEXT TWELVE MONTHS**
Basic Metals	-31%	-19%	-50%
Metal Products	-30%	-32%	-33%
Mechanical	-28%	-23%	-38%
Electronics	-21%	-21%	4%
Electrical	-12%	-41%	-29%
Rubber & Plastics	-25%	-10%	-33%
TURNOVER			
£0-9m	-20%	-25%	-29%
£10-24m	-16%	-23%	-28%
£25m and over	-27%	-22%	-31%

Source: Make UK Manufacturing Outlook Survey

PRICES & MARGINS

Both domestic and international margins have been low for UK manufacturers for a number of consecutive quarters. As a result, the impact of COVID-19 on profitability is not directly obvious in a sector that has conformed to operating in tight margins. Nevertheless, the pandemic still cut deep in last quarter's data.

The latest survey shows that UK selling prices have remained flat despite low inflation, but export selling prices have fallen to -3% on balance.

As the orders balances have indicated, UK margins have fallen over the last three months to -24%. Unfortunately, since the easing of lockdown and social distancing restrictions the domestic market is yet to report any sign of growth. Hence, some manufacturers have indicated an increase in their selling prices in order to recuperate greater funds with a lower number of sales. Conversely, export margins have improved somewhat in the same period, albeit enduring in negative territory, signifying international sales are returning before domestic orders. Contrary to last quarter, manufacturers have reduced the price of their export goods as opportunities for growth are more present in overseas markets than in the domestic one.

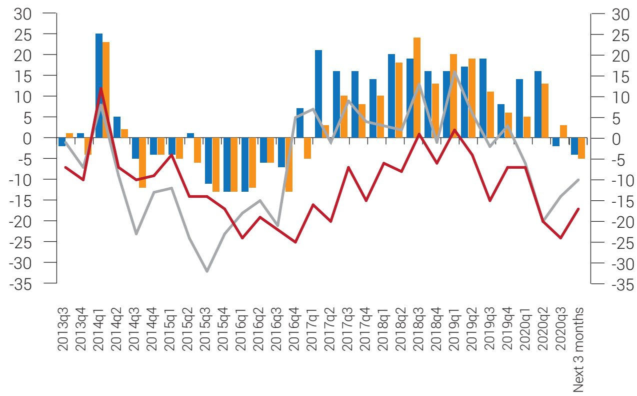
Over the next three months manufacturers expect prices and margins to improve, but only UK prices is expected to turn positive.

Following a series of low oil prices during the early days of the pandemic, the European Brent Price of oil averaged approximately $39 per barrel as households increased their consumption of fuels. However, the uncertainty around travel corridors between the UK and other countries remains an impediment to airline service.

The Sterling-Euro exchange rate averaged at €1.11 with little variance in response to COVID-19 updates. However, the rate does continue to be highly correlated to news stories belonging to developments in UK-EU trade negotiations.

Domestic margins decline again but export margins improve

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↑	0%	NEXT THREE MONTHS	↑	1%
EXPORT PRICES	PAST THREE MONTHS	↓	-3%	NEXT THREE MONTHS	↑	-1%
UK MARGINS	PAST THREE MONTHS	↓	-24%	NEXT THREE MONTHS	↑	-17%
EXPORT MARGINS	PAST THREE MONTHS	↑	-14%	NEXT THREE MONTHS	↑	-10%

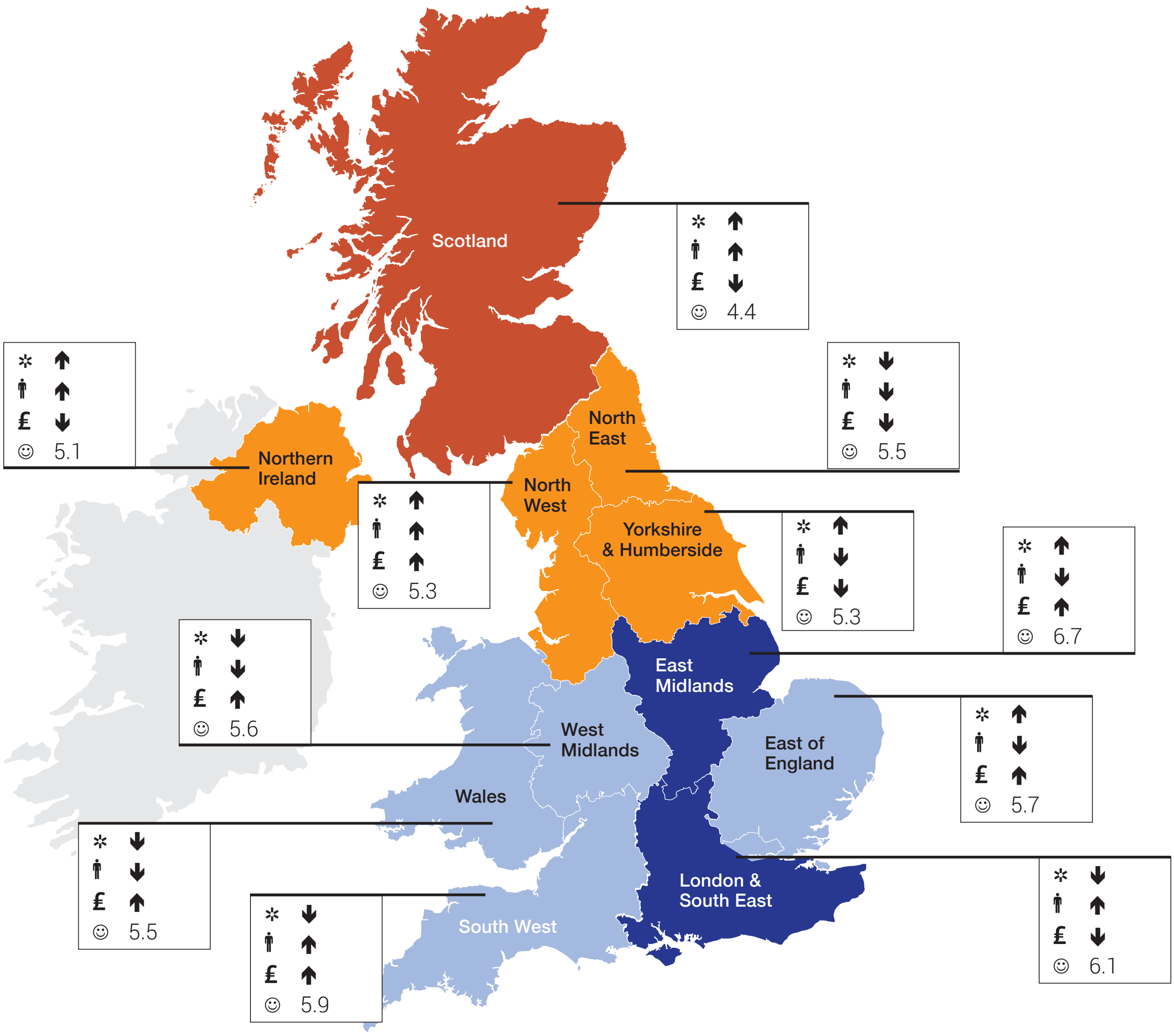
Mixed bag of results

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

Source: Make UK Manufacturing Outlook Survey

NATIONAL & REGIONAL

All regions and nations, barring Scotland, have reported positive, albeit marginal, business confidence this quarter. This tempered positivity reflects the UK's exit from the strictest of the lockdown measures which created a very difficult operating environment for manufacturers in the UK. In this quarter's research, the grouping of these confidence values is tight, telling of the homogeneity of some of the operational challenges businesses face throughout the country. Barring another UK-wide lockdown, confidence would be expected to creep upwards in a similar vein to that of orders and output.



KEY:

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

The map is coloured according to business confidence levels

HIGH CONFIDENCE

LOW CONFIDENCE

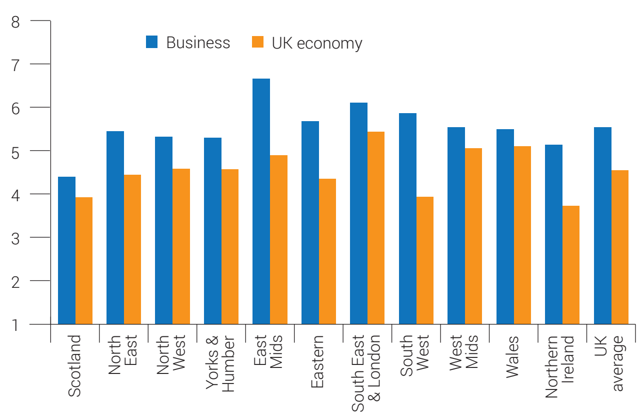
Source: Make UK Manufacturing Outlook Survey

The highest confidence levels were reported in the East Midlands and the South East & London regions, with levels reported at 6.66 and 6.11 respectively ('5' being the inflexion point between negativity and positivity). Out of all other regions and nations in the UK, these were the only two to report a value of 6 and above. While it is typical that the South East & London see higher than average confidence, the East Midlands will have seen such a rise as the very large manufacturing base located in that region getting back to business has had positive network effects on manufacturers' business outlooks.

The general increase in confidence across the UK this quarter, and the state-shift from negativity to positivity, has followed the tangible increase in production and orders seen over the past quarter. Whilst the manufacturing business environment is still a far cry from what it was prior to the pandemic, this slow-but-steady increase in manufacturing activity has had demonstrably positive impacts on regions' outlook in the short term.

Firm-level confidence returns to marginal positivity, although UK economy confidence remains negative

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



Source: Make UK Manufacturing Outlook Survey.

UK ECONOMY CONFIDENCE

UK economy confidence is typically lower than individual business confidence, and the same can be said this quarter. However, compared to last quarter's across the board negativity for UK economy confidence, there are now three regions and nations reporting marginally positive values. These are: South East & London, Wales and the West Midlands.

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	-39	-13	-40	-5	-35	-17
North East	-25	0	-50	-25	-42	-25
North West	-6	0	-29	0	0	-12
Yorks & Humber	-35	-10	-39	-6	-32	-48
East Mids	-32	26	-35	15	-26	-39
Eastern	-9	0	-23	-14	-36	-18
South East & London	-36	21	-24	21	-10	-4
South West	-31	-6	-31	0	-6	-19
West Mids	-29	3	-35	12	-44	-35
Wales	-78	-33	-56	-25	-11	-33
Northern Ireland	-47	-7	-50	-36	7	-20

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

There is no certainty as yet to what caused the initial outbreak of COVID-19 in late 2019, only that it originated from the Hubei province in China. Since then, few could have imagined the virus's potential to become a global pandemic as well as the health and economic impact it would have in the months to come.

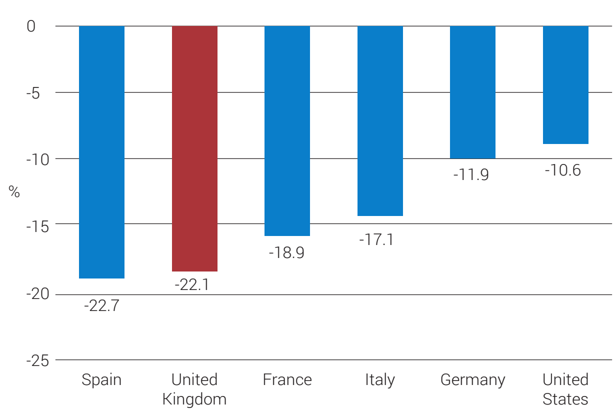
Indeed, as was recently confirmed, the UK is currently gnawing through one of its deepest recessions on record. Following a 2.2% GDP decline in Q1 2020, the UK witnessed a walloping 20.4% fall in activity in Q2 2020. According to the Office of National Statistics (ONS) the UK's GDP fell by more than double that of the United States across the first half of the year.

Looking at how different sectors of the economy fared, the services industry declined by 19.9% in Q2 2020. The manufacturing industry fell by 20.2%, whilst construction output fell by a staggering 35% during this time. Additionally, IHS Markit's April Manufacturing PMI reported a record low 32.6, where any value below 50 indicates a contraction in activity, citing COVID-19 as the primary cause of declines to output and new orders.

However, more recent PMI's have been indicating growth in manufacturing activity as restrictions are eased within the UK, as well as in oversea markets too. The latest estimates on the Index of Production (IoP) by the ONS also indicate that manufacturing output growth is leading the UK's recovery, growing by a substantial 11% in June 2020. Yet, since the sector has shrunk so dramatically as a result of the pandemic, this growth merely means the sector will be playing "catch-up" for the foreseeable future.

UK GDP fell more than double the US over the first six months of 2020

Cumulative GDP growth (%)



Source: ONS
Note: Chart shows the percentage change in real GDP in Q2 2020 compared with Q4 2019

Of course, it was not COVID-19 that directly impacted these sectors, but the lockdown policies enacted by Government designed to protect citizens, jobs and businesses that resulted in these record breaking declines. Despite the loss of activity, many of these policies were necessary.

One such policy is the widely used, Job Retention Scheme (JRS). According to HMRC's latest data, currently 9.6 million workers are furloughed across the UK with unique differences in take up across sectors and regions. The accommodation and food sector reported the highest take up rate, with 77% of workers furloughed, whilst business administration and support services have a take up rate of 32%. On average, the take up rate for manufacturing is 42% with over 1 million workers currently furloughed across 75,000 businesses. Of course, shielding workers from the impacts of lockdown comes at great cost, with the total value of claims for this scheme standing at £35.4 billion.

The ONS reported that UK public sector debt has exceeded £2 trillion for the first time — more than four times the level during the Global Financial Crisis.

Although it is not yet observed in the latest data, forecast data from Oxford Economics indicates the unemployment rate could rise to around 4.8% this year, and increase further to 5.7% in 2021 as the economy endeavours to recover from its deepest recession. Make UK's recent Manufacturing Monitor surveys have also indicated that 42% of manufacturers have already executed plans for cutting staff, whilst a further 30% are planning to make redundancies over the next six months.

The latest figures from the Organisation for Economic Cooperation and Development (OECD) reports a mixed set of results for inflation. In most cases, the inflation rate — measured by the consumer price index — grew marginally in June 2020. For example, in the United States the inflation rate increased by 0.6% when compared with this time last year, whilst Germany saw a growth of 0.9%. China, however, reported an inflation rate of 2.5% as widespread flooding across the country's southern regions resulted in food prices spiking. According to the ONS, the UK's inflation rate stands at 1.1% in June, up from 0.8% the previous month, as upward contributions from fuel prices, clothing items, furniture and household goods increased the cost of living for an average consumer. However, for the time being falling food prices have also eased the immediate burden on the consumer's wallet – particularly as the Government's "Eat out to help out" scheme and VAT cut for the hospitality sector started in August. It is expected in the short run, inflation will continue to be low and below the Bank of England's (BoE) 2% target.

Nevertheless, many of these policies are unsustainable in the long-run and therefore most will expire before the year end. The biggest concerns for policymakers now will be to prevent a disastrous fall off a cliff edge for vulnerable industries when it's most powerful support mechanism, the JRS, expires at the end of October. Make UK recently called for an extension to manufacturing subsectors that are vulnerable but maintain a key strategic status to the UK's competitiveness on the world stage. These include the Automotive and Aerospace subsectors. There are approximately 157,000 workers furloughed within these two industries alone (HMRC).

A critical factor that will play a significant role in the recovery of these industries, as well as others, will be access to skills.

Make UK's recent Manufacturing Monitor found that 3 in 10 manufacturers had put some or all of their apprenticeship training on hold. To some extent, this has been owing to colleges and training providers being forced to close during lockdown. Indeed, we are now hearing reports that companies are restarting their apprenticeships as we head into the academic year and education providers have been given the green light to fully reopen. That said, the impact of COVID-19 is having an impact on employers' ability to offer invaluable apprenticeship opportunities. Make UK research has found that the number of companies planning to recruit apprentices in the next 12 months is 48%. While seemingly high in comparison to other sectors, traditionally this figure would be seen at circa 75%.

As UK manufacturers catapult themselves into the digital age making use of new technologies such as artificial intelligence, augmented/virtual reality, 3D printing (additive manufacturing) and the Internet of Things (IoT) there will be an increasing need to develop these skills with not only the existing labour force, but the incoming one as well. Yet, previous and forthcoming Make UK research shows that the greatest barrier to the adoption of these new technologies is a lack of digital skills.

However, as Make UK's latest survey indicates many UK manufacturers simply do not have the required cash-flows to invest in these technologies, let alone the volume of apprentices and skilled employees to operate them. The start of the decade indicated many manufacturers were prepared to increase their capital expenditures before the barriers raised by the COVID-19 pandemic. Since then, firms have operated on a subsistent basis and accessed various Government support schemes, such as the Coronavirus (Large) Business interruption Loan Scheme (C(L)BILS), in order to manage working capital expenses.

As the UK's public debt has exceeded £2 trillion, there is also a growing concern for the growing private sector debt, particularly in manufacturing which represents a large proportion of UK SMEs. If not managed appropriately, the value of the debt owed will balloon and discourage firms from taking on additional funds to finance growth.

All the while the UK continues to prepare for its exit from the European Union, which has legally already taken place but the practical changes remain unknown and will be implemented in January 2021. All things standing, the UK-EU negotiations are still progressing and coinciding with these discussions is the country's efforts to form trade deals with other key markets, such as the United States and Japan (now formed as of publication) too. For some manufacturers, the outcome of these negotiations are more important than the impact of COVID-19. So far, of all the deals the EU had already in place which the UK benefitted from, only 8% of these have been rolled over accounting for free trade between the UK and 50 small countries or territories[1].

1 BBC (20 July 2020), "Brexit: What trade deals has the UK done so far?", Available at: https://www.bbc.co.uk/news/uk-47213842

Despite the negative impact both the pandemic and the new trading environment will have, some may wonder how society will evolve going forward. For example, many workers have already shifted to working from home and according to the ONS, occupations that require higher qualifications reported greater opportunities for home working. If this is to become a norm, it may have a redistributive impact on the Government's levelling up agenda, particularly if high earners in the City of London were to move away in order to benefit from a lower cost of living in rural areas. This would benefit the GDP per capita in those areas, but equally result in a reduction in activity within urban locations that thrive on local employment concentrations. Whether the net change in welfare will be positive or negative remains to be seen. Yet, the details of which will be less relevant to manufacturing – a sector with fewer opportunities for remote working due to the high proportion of production employees and fewer office-based staff.

UK Economic Forecasts

% change except where stated

	2019	2020	2021
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.14	1.12	1.12
Exchange rate ($/£)	1.34	1.28	1.27
Exports	5.0	-19.0	11.8
Imports	4.6	4.6	-21.8
Current account (% GDP)	-4.0	-3.0	-3.7
OUTPUT			
Manufacturing	-1.5	-10.9	5.1
GDP	1.3	-8.5	10.1
COSTS AND PRICES			
Average earnings	3.5	0.1	2.5
Oil price (Brent Oil $/bl)	64.4	43.4	49.1
EMPLOYMENT			
Manufacturing (000s)	2,711	2,667	2,603
Rest of economy (000s)	35,703	35,389	35,084
Unemployment rate (%)	3.8	4.8	5.7

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

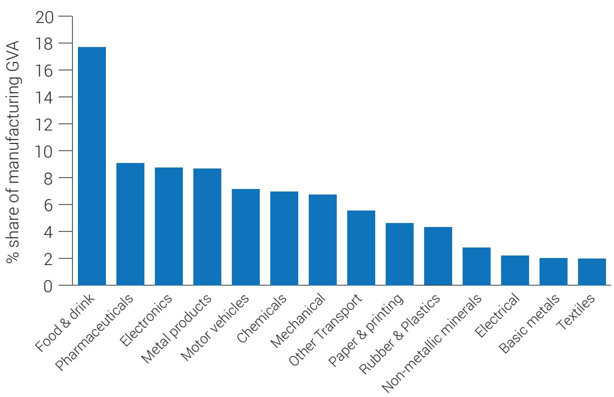
	GDP			INFLATION		
	2019	2020	2021	2019	2020	2021
US	2.2	-4.0	4.3	1.8	1.0	1.6
Eurozone	1.3	-7.8	6.4	1.2	0.4	1.4
France	1.5	-10.1	7.4	1.1	0.5	1.3
Germany	0.6	6.3	5.8	1.5	0.6	1.8
Japan	0.7	-6.0	2.8	0.5	-0.3	0.0
China	6.1	2.5	7.9	2.9	3.0	1.9
India	4.9	-5.7	8.0	3.7	5.2	3.4
World (2015 PPPs)	2.8	-4.1	6.0	3.2	2.7	2.8

Source: Oxford Economics

SECTOR FORECASTS

Pharmaceuticals becomes the 2nd largest sector (Q3 2020)

Subsector share of Manufacturing Gross Value Added



Source: ONS

FOOD & DRINK

The **Food & Drink** subsector remains the UK's largest manufacturing subsector in terms of GVA, however, despite assumptions that it will have been one of the better-faring subsectors during the pandemic due to such high commercial demand for its products, it has in fact seen its total GVA contribution to the UK's manufacturing composition fall, albeit by only 1%. Although consumer grocery demand has been infamously high during the pandemic, the total loss of the hospitality and foodservice sectors caused woes for the industry. The recent and popular "Eat out to help out" scheme in the UK has significantly stimulated demand for the hospitality foodservice sector, although worry remains that with the scheme's end, so too will demand. These worries are severe enough that despite renewed consumer demand, the total year's output for 2020 is forecast at -4.1%.

ELECTRONICS

The **Electronics** subsector enjoyed the best performing output growth in 2019 out of all manufacturing subsectors. While our forecast for output in 2020 is indeed negative, it is the least negative forecast, standing at -3.3%. The subsector has managed to weather the COVID-19 pandemic and its subsequent economic storm the best. In large part, this is due to a surge in the number of businesses seeking to digitalise their processes, which has afforded the electronic subsector a certain degree of consistency in demand for its products over other subsectors, even during the height of the pandemic. Naturally, the subsector suffered from many of the challenges that faced the industry as a whole, such as a difficulty in sourcing reliable component providers and international freight backlogs limiting output levels. Nevertheless, with this demand for products from the subsector to continue, we can expect more consistency in its output performance outlook than we can for other subsectors.

BASIC METALS AND METAL PRODUCTS

For the **Basic Metals** subsector, its current output performance and subsequent forecasted performance is firmly attached to the performance of producers that use those basic metals as intermediate goods. Following the COVID-19 pandemic, the slow recovery of the automotive, aerospace and construction sectors, key purchasers for the subsector, will have continued suppressive effects on the subsector's output for the quarter ahead. Potential future lockdowns are unlikely to lead to Basic Metals plants ceasing operation, as the majority continued to work throughout the first lockdown, but the demand is unlikely to return to pre-COVID levels in the short term, and as such, a -13.7% decline is expected in output for the subsector in 2020.

The **Fabricated Metals** subsector experiences a similar exposure to volatile demand from downstream consumers of its products. In terms of GVA to the manufacturing sector, this subsector has fallen from 2nd largest to 4th in one quarter. The Aerospace subsector in the UK is a large consumer of its products, and with the current output struggles that the Aerospace industry faces, demand in the Fabricated Metals subsector is being weighed upon. Further compounding the short term problems facing this subsector, its labour-intensive nature of production means that maintaining social-distancing can be challenging for firms, and in some cases forcing them to work at reduced levels of output. Nevertheless, demand for products from this sector is unlikely to see an explosive recovery and output for the year is forecasted to be -12%.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector has been one of the hardest hit by the economic effects of the pandemic. This subsector typically benefits directly from an expansionary capital expenditure attitude within the business community. As investment since the inception of the pandemic, and even before, has been so low that the majority of businesses have cancelled plans to invest in new machinery and equipment and instead repurpose such cash towards business continuity. However, as a result, what we see is the Mechanical Equipment subsector starved of orders amongst such a cautionary investment environment. Output for the subsector is forecast at -25% in 2020.

TEXTILES

Compared to the previous quarter, the **Textiles** subsector has seen its forecasted output for 2020 revised down again. The subsector already faced stiff competition from abroad, particularly in the East where the comparative advantage of cheap labour costs has forced many domestic Textiles manufacturers out of the middle-to-low end of the industry. Premium textile manufacturing is typically where the majority of the subsector sits, but as individuals in the economy see their spending power decrease, premium offerings, from any subsector, are in store for a large and continued drop in demand. The output forecast for the Textiles sector is bleak, standing at -25.7%, the second most severe expected output contraction in the industry.

PAPER & PRINTING

The **Paper & Printing** subsector is expected to see a contraction in its output for 2020 in line with the UK's manufacturing average, at -10.7%. This expectation would have likely been more pessimistic had it not been for the boom in demand for packaging from domestic customers. A large amount of COVID-19-related printing work has been commissioned by both the Government and the private sector in a bid to mitigate the risks of a second wave of infections whilst still being able to operate the business, even if at a reduced level. However, it exists as another subsector that sees its competitive advantage eaten away at by virtue of subdued investment, leaving it and its customers at risk of seeking similar products from foreign competitors. Post-COVID demand for products from the subsector are likely to remain high, as life gets back to a shadow of normality, increased levels of packaging and printing will remain.

ELECTRICAL EQUIPMENT

Not unlike the majority of manufacturing subsectors, the **Electrical Equipment** subsector suffers from a bleak outlook in 2020. Output is forecast to be down by -14.7% this year, and employment down by -10.2%. UK construction activity accounts for roughly £5 billion of value for the subsector, and Aerospace £2.5 billion. Construction activity has started to resume in earnest, albeit at far lower levels than before, but Aerospace remains in critical condition. Whilst private market demand has fallen significantly due the COVID-19 crisis, there remains a hope that large impending UK infrastructure projects funded by Government may soften the blow somewhat for those who can secure the domestic contracts. That is, however, assuming that the Government does still plan to go ahead with its rumoured large infrastructure plans that had been formulated prior to the pandemic.

NON-METALLIC MINERALS

The most recent positive indicators from the construction sector will hold a lot of hope for the **Non-Metallic Minerals** subsector. After an incredibly dismal run of months with very little construction activity in the UK, sites are now beginning to open and construction work is taking place in earnest. As a key supplier to the industry (bricks, glass, mortar, etc.), this re-opening of sites should stimulate demand for the subsector's goods, however, it will likely be many months away before construction activity returns to levels prior to the pandemic. Confidence in the UK economy has been knocked, so the commissioning of construction projects is also more unlikely than before. Although we hold a negative forecast for output for the subsector in 2020, it is not as severe as other subsector's forecasts and sits roughly in the middle of the pack at -15.8%.

PHARMACEUTICALS

The **Pharmaceuticals** sector stands in stark contrast to other subsectors as it is the only one forecast to see positive output growth in 2020. Not only is the growth positive, but double-digit growth is expected, at 13.6%. Employment in the sector is also expected to boom, at least in the short term. Expectedly, most of this growth in output and employment comes on the back of the huge demand boost for the subsector's existing and novel products that are interventions to the COVID-19 pandemic. Of course, we see this growth as a temporary demand shock, but it is a shock that will likely last for at least a year, not just a couple of months. As the pandemic subsides, this inflated output will follow suit, but a lot depends on whether this pandemic's effects are a protracted affair over the coming years or not.

CHEMICALS

The **Chemicals** subsector's outlook for 2020 output is the third 'best' at -3.6%. Typically we could consider that a worryingly negative result, but given the relative negativity in output being experienced by other subsectors, this result is just mild by comparison. This subsector has seen a large boost in demand for sanitisation products worldwide, both domestic and industrial. While the Chemicals subsector is far more diverse than just such products, the meteoric rise in their daily use throughout life in the 'new normal' has generated a novel revenue stream for firms in the industry concerned in their production. Further, to allow domestic Chemicals producers to meet demand, the Government has relaxed many of the regulations around product classification in the sector, allowing firms to be agile in repurposing production lines to produce products they may not have typically produced in the past, quickly.

RUBBER & PLASTICS

In the **Plastics** industry, a recent increase in demand for single-use plastics, such as the likes seen commonly employed in PPE, will have provided some degree of demand benefit for the subsector during the downturn. This demand-stream is, however, unlikely to be long-lived and is at odds with the industry's sustainability agenda. Both the boom in grocery delivery and consumers' newfound proclivity for increased packaging of goods will have also contributed to this demand cushion.

As the **Rubber** subsector in the UK is primarily comprised of demand from the tyre market, the abysmal level of new car registrations this year has meant that the Rubber subsector has seen a large portion of its own output follow suit. Together for the **Rubber & Plastics** subsector, output is forecast at -10.6% for 2020.

MOTOR VEHICLES (AUTOMOTIVE)

The outlook for the **Motor Vehicles** subsector's output is the bleakest of the entire industry in 2020. Having already suffered the worst relative decline in output across UK manufacturing in 2019, the output forecast for 2020 is so severely negative that the previous year's negativity pales in comparison. New car registrations are down to approximately half of what they were year-to-date, as might have been expected given big-ticket items such as cars are often the first goods consumers cut out when under constrained personal finances. This gargantuan drop in demand, combined with the loose footing of the subsector pre-COVID, leads output to be forecast at -32% for 2020. However, presuming demand returns in line with a general economic recovery throughout the rest of 2020, we would expect to see a large proportion of this lost output recouped in 2021.

OTHER TRANSPORT

The core industries that comprise the **Other Transport** subsector are Defence, Aerospace and Shipping. Many key firms in the sector have already publicly announced large scale redundancies. A heavily subdued travel sector has had scarring impacts on those involved in the manufacture of such transport equipment, with many travel providers no longer needing large orders from the subsector due to a cliff-edge drop in demand. A recent piece of research by the British Ports Association showed that approximately two-thirds of British ports felt their trading future was in jeopardy as a result of the global freight downturn incurred by the pandemic. Nonetheless, this subsector typically has long order books, as the process from purchase to delivery can take years, so it is hoped that as long as the economic effects of the pandemic dissipate within months as opposed to years, there remains a hope that the strong fundamentals of the subsector in the UK will be able to recoup its losses in time. Output balance is forecasted at -12.3% for 2020.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2019	2020	2021	2019	2020	2021
Basic metals	-3.5	-13.7	3.8	1.4	-7.1	-3.0
Metal products	0.1	-12.0	3.0	3.1	-6.0	-5.0
Mechanical	-5.3	-25.0	10.3	2.5	-0.7	-2.6
Electronics	2.4	-3.3	2.7	-0.6	13.9	-6.2
Electrical	3.8	-14.7	1.2	3.7	-10.2	-2.1
Motor vehicles	-7.1	-32.0	32.2	3.1	-10.7	-6.9
Other transport	-1.2	-12.3	3.2	0.8	-6.8	-8.1
Food & drink	2.4	-4.1	3.8	2.1	2.2	-1.8
Chemicals	-0.5	-3.6	-1.8	3.4	2.8	-9.4
Pharmaceuticals	4.2	13.6	-6.0	1.0	25.7	-13.9
Rubber and plastics	-1.9	-10.6	2.9	-1.8	5.2	1.7
Non-metallic minerals	-5.9	-15.8	11.3	3.7	-8.2	7.8
Paper and printing	1.2	-10.7	5.1	-2.5	-5.3	-0.1
Textiles	1.3	-25.7	9.0	-1.5	-6.1	4.5
Manufacturing	-1.5	-10.9	5.1	0.4	-1.6	-2.4

Source: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

ACTIONS TO ADDRESS A DOWNTURN TO SURVIVE THE PANDEMIC

Our Q3 Manufacturing Outlook survey provides first hand evidence that many manufacturers are continuing to struggle despite clawing back some lost ground compared to what was a cataclysmic Q2 for the sector. It now looks increasingly likely that COVID-19's impact on the global economy will weigh heavily on business confidence and consumer spending well into 2021 and beyond, leaving many UK manufacturers exposed. Lost output and income could significantly increase balance sheet liabilities and debt burden.

Navigating this new landscape will be a challenge and restructurings are likely to be common. This will not only impact jobs in individual companies, it will also affect companies within the interconnected supply chain and local economies.

Most manufacturers responded well to the initial impact of COVID-19, focusing on minimising the immediate effects on business operations, reducing costs, preserving cash and implementing necessary measures to ensure employee safety.

Many of these actions were designed to address a short-term downturn. But with a 'V shaped' recovery and a quick return to pre-COVID volumes looking increasingly unlikely, it could be two to three years before demand recovers for some manufacturing sectors. For these businesses to survive in the medium to long term more fundamental actions may be required.

These could involve more structural, permanent changes to business operating models, including:

- Critically assessing the company product portfolio. This could involve ceasing production of non-core/low value add products and investing in new products and services in more resilient and profitable business sectors.
- Restructuring the business through closing sites. This could involve exiting UK and international factories and consolidating production locations as well as assessing the impact of the exit from the EU.
- Downsizing the organisational structure in operational and back office functions.
- Insourcing production from sub-contractors to utilise spare production capacity within the existing manufacturing footprint.
- Divesting underperforming business areas or winding up if not sellable. This would allow the company and management team to focus on core, more profitable operations.
- Consolidating and de-risking the supply chain. This would involve reducing suppliers to drive up/ maintain volumes with a smaller number of key suppliers and repurposing the supply base closer to home to reduce the risk of supply chain disruption.

Implementing one or a combination of these actions will require a business transformation programme to be set up and it is likely that management teams will require additional support to define, plan and implement agreed actions. Additional or alternative funding may also be required to fund the business transformation.

For distressed manufacturing businesses, the new restructuring provisions within the recently introduced Corporate Insolvency and Governance Act 2020 ('CIGA') are a welcome addition to the available restructuring tools, especially as these are debtor-led processes that allow a company to control its own restructuring process.

Although COVID-19 has had a significant impact on the manufacturing sector, we would suggest that companies should respond positively to the challenges and use the pandemic as a catalyst for change and an opportunity to build resilience into their operations. Many of our clients have already embarked on this journey and are actively in the process of reshaping their businesses.

A more detailed version of this article which includes an assessment of which UK manufacturing sectors are likely to be at risk as a result of a longer recovery period can be accessed here.

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

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

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

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

MakeUK.org

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The data used in this survey have been provided by UK manufacturers including members of Scottish Engineering, Manufacturing NI, and Make UK. Contributing to our surveys helps to accurately reflect trends and behaviours that shape the UK manufacturing sector.

If you would like to participate in future surveys, please contact our Information and Research team research@Makeuk.org

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Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,800 offices in 167 countries. We operate from 17 offices across the UK, employing 5,150 people offering tax, audit and assurance, and a range of advisory services.

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

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

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

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

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

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