The manufacturers' organisation

In partnership with:

DLA PIPER

MANUFACTURING OUTLOOK

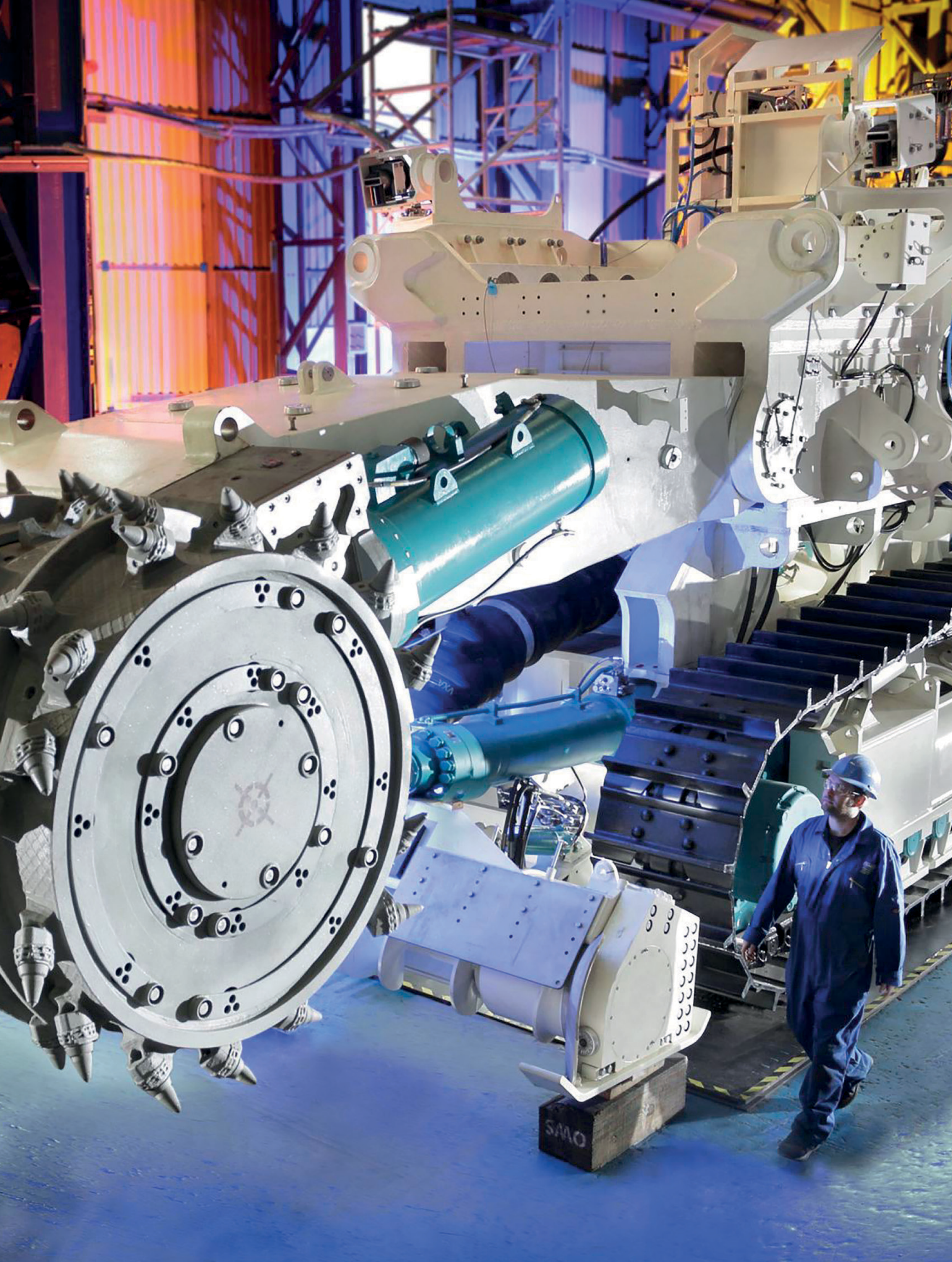
2015 QUARTER 1

2.6 million employees

1/2 of UK exports

72% of business R&D

Average wages higher than the rest of the economy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FOREWORD

Lee Hopley
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Welcome to our new look *Manufacturing Outlook* report covering activity in manufacturing in the first quarter of 2015. This is not just the first edition of the year, but also the first in partnership with DLA Piper.

Last year was a good year for both growth in the economy as a whole and in UK manufacturing. While there were signs of softening activity towards the end of 2014, our latest survey suggests that this year has got off to a relatively strong start for many manufacturers with output picking up in the first few months of 2015.

The economic background to our survey this quarter continued to be rather turbulent. At the time of writing, a number of key uncertainties in the eurozone, which could significantly impact the short-term performance of manufacturing, remained. Manufacturers responding to our survey appear to have been looking through the protracted negotiations between Greece and eurozone finance ministers, with some reporting signs of improving demand from European customers.

Indeed, the balance of responses on export orders nudged back into positive territory for the first time since 2014q2 – a potential sign that an improvement in the sector's trade performance is on the horizon.

Another significant development over the past few quarters has been the sharp decline in the oil price – a boon for consumers, but a mixed blessing for UK manufacturers. Clearly a fall in input costs and stronger consumer spending – not just in the UK, but in most advanced economies – provides a more supportive backdrop for manufacturers. However, the negative effects on oil and gas activity and the impact through the industrials supply chain are more evident in our survey this quarter.

At the wider industry level, manufacturers' investment and recruitment plans continue to hold up, pointing to some continuing confidence about the health of demand prospects. And new to our survey this year is an economic confidence indicator which will monitor expectations for the next 12 months. There are some significant domestic developments – a forthcoming Budget, an uncertain election and a tough Spending Review – in the calendar for this year, but companies are reporting moderately positive expectations for the year ahead and cautious optimism about their own business performance.

2015Q1 HEADLINES

Manufacturing activity has continued to expand for a net balance of companies over the past three months. Output responses remain positive, but the orders picture has softened in some sectors. Cautious optimism remains as firms report on-going plans to recruit and invest.

INDICATOR	BALANCE	CHANGE	
Confidence	6.2%	↑	Optimism about the economic outlook falls
Output	17%	↑	Seven quarters of positive balances
UK orders	21%	↑	Recruitment hit one year high in past three months
Export orders	11%	↑	UK orders stronger than exports for fourth consecutive quarter
Employment	-3%	↓	Second quarter of decline
Investment	16%	↓	Weakest investment intentions for two years

Source: EEF Business Trends Survey

In our latest survey, manufacturers have reported positive output balances for the eighth consecutive quarter, but at 13% the balance of responses was a touch weaker than the 17% reported three months ago, but not out of line with forward-looking expectations in our previous report.

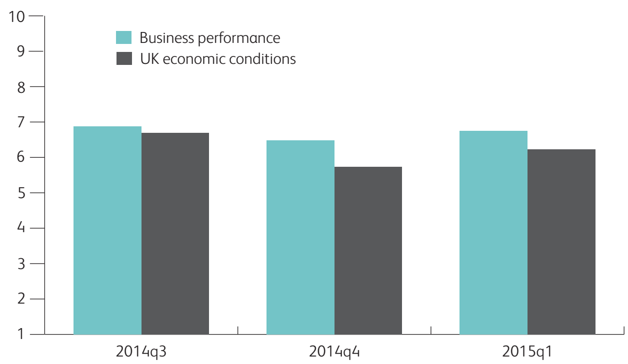
Orders balances further drifted down over the quarter, with the balance of companies reporting growth in total orders coming in at 5%, again in line with last quarter's expectations. However, the domestic picture was weaker than anticipated with a balance of just 1% of companies reporting growth in UK sales. While there was a similar balance on overseas sales this marks an improvement on recent quarters when responses were negative.

One of the major economic news stories in recent months has been the low oil price and the flow through into very weak consumer price inflation. The effects of falling oil prices are also evident in manufacturing with evidence of falling prices in sectors such as chemicals and rubber and plastics. Nevertheless, margins balances have remained stable. However, sectors such as mechanical equipment have seen some negative impacts on orders following delays or cancellation of investment projects in the extraction sector.

Two key new measures introduced this quarter are confidence indicators covering business conditions and overall activity in the UK economy. On both indicators there are moderate levels of optimism about growth in the next 12 months, with marginally higher confidence levels about business performance compared with UK economic prospects. Manufacturers in the transport sector report the highest levels of confidence on both measures, but no sector is currently planning for deterioration in activity over the course of this year.

SLIGHT PICK-UP IN CONFIDENCE

CONFIDENCE IN THE NEXT 12 MONTHS 1 = SUBSTANTIALLY WORSE, 10 = SUBSTANTIALLY BETTER



Source: EEF Business Trends Survey

OUTPUT

2015 has got off to a solid start for manufacturing, with a balance of 13% of manufacturers saying output increased in the past three months. Although this was somewhat softer than last quarter's output balance of 17%, it remains firmly positive and is a little stronger than expectations reported in last quarter's survey.

PAST THREE MONTHS	↓	13%
NEXT THREE MONTHS	↑	21%

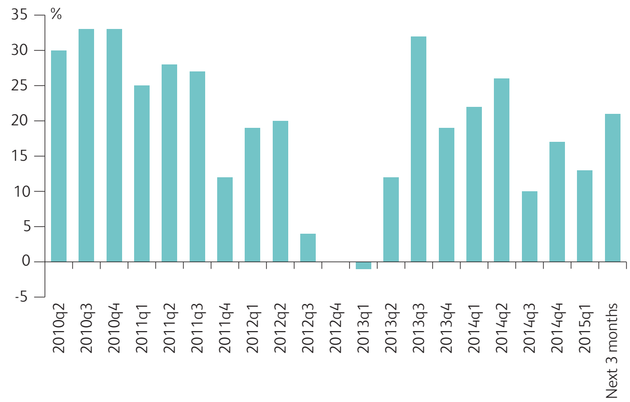
This positive balance in the past three months reflects growing output in most manufacturing sectors, with particularly strong balances in electronics and motor vehicles, building on momentum from 2014. However, there was some sector divergence. Most notably, the basic metals sector was negative, with a balance of 15% of companies saying that output had fallen in the last three months. This reflects expectations in last quarter's survey, where basic metals manufacturers were the only sector forecasting a fall in output.

In addition to a positive sectoral picture, there was positivity across all sizes of firm in our survey, although the smallest companies, with a turnover less than £10m, recorded an average output balance of 6% in the past three months compared with a net balance of 20% of the largest companies (£25m+ turnover) seeing rising output.

It is likely that this generally positive start we have seen to the year will continue. Manufacturers are optimistic about the next three months, with a balance of 21% of companies thinking output will increase. Manufacturers of all sizes and in all sectors reported positive expectations, though sector differences will persist in the next quarter, with the weakest forward-looking expectation in mechanical equipment and the strongest in motor vehicles.

MANUFACTURERS REPORT AN EIGHTH CONSECUTIVE QUARTER OF GROWTH

% BALANCE OF CHANGE IN OUTPUT



Source: EEF Business Trends Survey

OUTPUT SUMMARY

% BALANCE OF CHANGE

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
Basic metals	-15	20
Metal products	9	26
Mechanical	3	5
Electrical	16	39
Electronics	29	18
Motor vehicles	25	43
Other transport	20	75
TURNOVER		
£0-9m	6	26
£10-24m	18	20
£25m and over	20	28

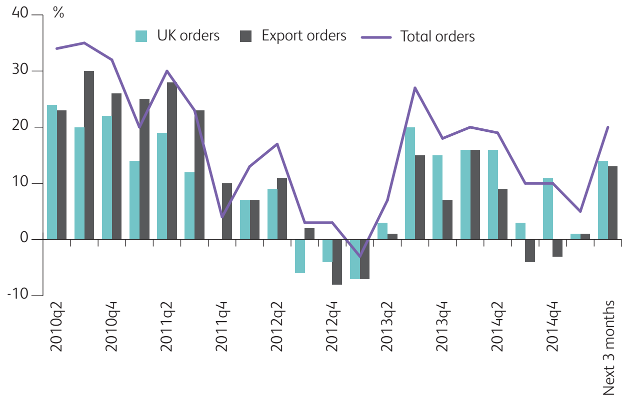
Source: EEF Business Trends Survey

ORDERS

The total new orders balance softened in the last three months from 10 % in last quarter's survey to 5 % this quarter. This reflects a softening in the UK picture and a slight improvement in the export picture.

UK AND EXPORT ORDERS SEE SLIGHT GROWTH AT THE START OF 2015

% BALANCE OF CHANGE IN ORDERS



Source: EEF Business Trends Survey

UK ORDERS	PAST 3 MONTHS	↓	1 %	NEXT 3 MONTHS	↑	14 %
EXPORT ORDERS	PAST 3 MONTHS	↑	1 %	NEXT 3 MONTHS	↑	13 %
TOTAL ORDERS	PAST 3 MONTHS	↓	5 %	NEXT 3 MONTHS	↑	20 %

UK ORDERS

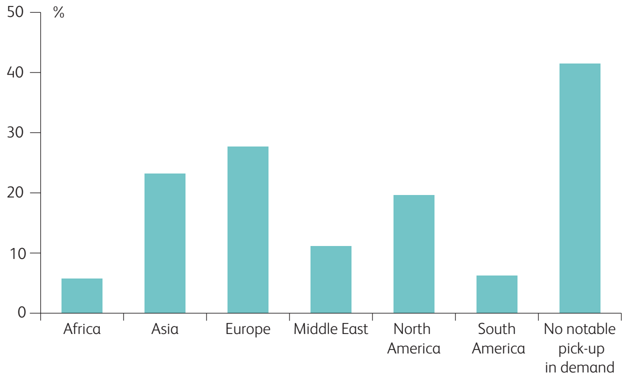
The balance of companies reporting an increase in UK orders this quarter was 1 %, down from 11 % in 2014q4 and some way below expectations. However, this weakness in UK demand is limited to a few sectors, particularly those focused primarily on the oil and gas supply chain. Some of the sectors with a high presence in the UK oil and gas supply chain are basic metals, metal products and mechanical equipment. In each of these cases, manufacturers reported that UK orders had fallen in the last three months. This is particularly pronounced in basic metals where the balance of companies reporting falling demand was 26 %.

The electrical equipment sector is also a key supplier into the oil and gas sector, but here companies have seen positive orders growth. This reflects the impact of infrastructure and building projects coming on stream, and these will be supporting demand.

In contrast to those companies in the oil and gas supply chain, those in consumer-facing sectors have seen an improvement in UK demand as the falling oil price has a similar impact to a tax cut for households. Indeed, consumer-facing sectors – most notably food and drink and motor vehicles – report strong domestic demand, with balances of 55 % and 25 % of companies in these sectors reporting increased UK orders respectively. For these sectors, strong demand is expected to continue into the next three months as well.

EXPORT DEMAND FROM EUROPE ON THE RISE

% OF COMPANIES REPORTING IN CHANGE IN DEMAND BY MARKET



Source: EEF Business Trends Survey

EXPORT ORDERS

Export orders improved in this quarter's survey, with a balance of 1 % of companies reporting an increase in overseas demand in the last three months. While not a strong balance, this is the first time manufacturers have reported growing export demand since 2014q2. This is consistent with the pick-up in manufactured exports reported in official data in the last few months of 2014.

A large minority of manufacturers said that export markets had not improved much in the past three months, with 42 % of exporters reporting no notable pick-up in demand. For many manufacturers, the improving export picture has been a result of proactive work to seek new export orders.

In smaller companies, which are less likely to have exposure to non-traditional and high-growth export markets, the export picture is still in negative territory. A balance of 1 % of companies with turnover under £10m reported falling orders in the last three months in contrast with larger companies who reported positive balances.

As well as variation by size, there is also a strong degree of variation by sector, with motor vehicles manufacturers among the most likely to have reported an increase in export demand. This was particularly linked to demand from Asia and Europe.

Looking to the next three months, manufacturers are optimistic that positive export trends will continue, with a balance of 13 % of companies expecting rising overseas demand. The largest companies remain the most positive. While manufacturers have taken efforts to diversify their export markets and shore up demand, there remain considerable risks around this positive outlook, with growth in the eurozone looking particularly uncertain.

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	-26	5	-6	41	-10	25
Metal products	-1	27	6	0	-1	25
Mechanical	-13	-5	-6	1	0	2
Electrical	22	15	-3	13	14	23
Electronics	11	33	18	39	14	41
Motor vehicles	25	21	36	25	25	33
Other transport	0	75	-20	50	0	75
TURNOVER						
£0-9m	-9	32	-1	16	-3	29
£10-24m	16	8	17	12	16	17
£25m and over	9	14	8	24	18	24

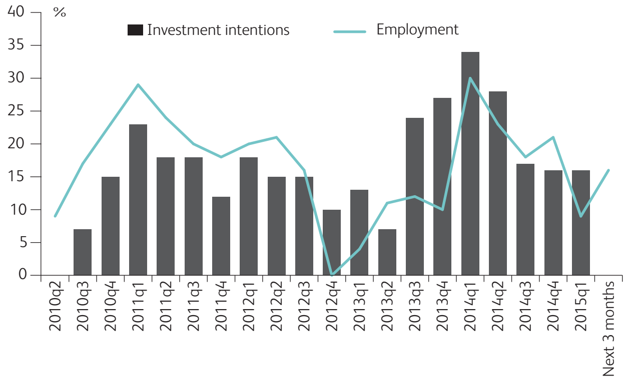
Source: EEF Business Trends Survey

EMPLOYMENT & INVESTMENT

Recruitment balances have softened for 2015q1 but expectations are solid for the next three months; robust investment intentions continue to underpin output growth.

EMPLOYMENT AND INVESTMENT GROWTH SET TO CONTINUE

% BALANCE OF CHANGE



Source: EEF Business Trends Survey

EMPLOYMENT	PAST 3 MONTHS	↓	12%	NEXT 3 MONTHS	↑	14%
INVESTMENT	PAST 3 MONTHS	↔	16%			

The employment balance was positive at 9% for the past three months but slowed from the 17% seen in the last quarter of 2014. The basic metals sector represented the main drag for 2015q1 with a negative balance of -15%. In contrast, electrical, electronics and motor vehicles all had employment balances well in excess of the manufacturing average in the past three months.

The overall employment balance remains well above the long-term average for manufacturing which stands at -3%. Recruitment intentions for the next three months are solid at 16% as sustained activity by manufacturers should boost employment. There is particular strength in recruitment plans amongst small and medium-sized manufacturers in the coming quarter.

Investment intentions remain particularly robust among manufacturers. The investment balance stayed at 16% for 2015q1 indicating optimism for the year ahead. Investment activity has come off the boil somewhat since the second half of 2014 reflecting the overall slowing in the pace of growth across the sector.

Positive intentions were broadly based across sectors with only basic metals reporting a negative balance while chemicals stayed flat. Both sectors contracted in 2014 and are expected to struggle for growth in 2015. Encouragingly, the increase in the investment balance was distributed evenly across business size, with both small and larger business at 13%.

EMPLOYMENT AND INVESTMENT SUMMARY

% BALANCE OF CHANGE

	EMPLOYMENT		INVESTMENT
SECTOR	**PAST 3 MONTHS**	**NEXT 3 MONTHS**	**PAST 3 MONTHS**
Basic metals	-15	5	35
Metal products	1	15	-2
Mechanical	7	12	11
Electrical	11	19	23
Electronics	14	14	15
Motor vehicles	25	33	40
Other transport	0	80	50
TURNOVER			
£0-9m	8	17	13
£10-24m	17	20	15
£25m and over	4	6	13

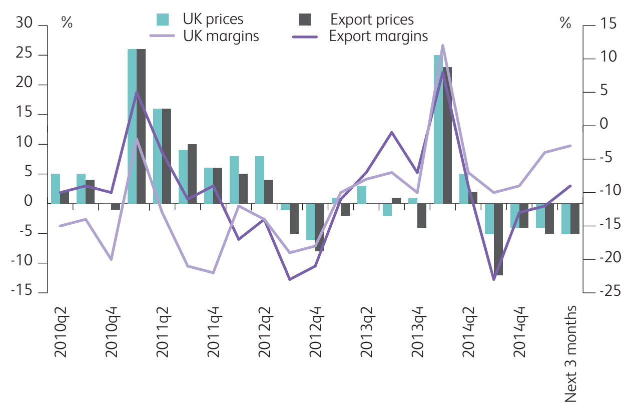
Source: EEF Business Trends Survey

PRICES & MARGINS

Official data point to tumbling input costs for manufacturers, largely driven by the sharp fall in the oil price. Overall, a balance of manufacturers reported falling prices on both domestic and export sales and while margins balances were also negative, these were slightly better than three months ago.

PRICE BALANCES REMAIN STABLE

% BALANCE OF CHANGE



Source: EEF Business Trends Survey

UK PRICE	PAST 3 MONTHS	↔	-4%	NEXT 3 MONTHS	↔	3%
EXPORT PRICE	PAST 3 MONTHS	↓	-5%	NEXT 3 MONTHS	↑	0%
UK MARGINS	PAST 3 MONTHS	↑	-4%	NEXT 3 MONTHS	↑	-1%
EXPORT MARGINS	PAST 3 MONTHS	↑	-12%	NEXT 3 MONTHS	↑	-14%

A balance of 4% of manufacturers reported a fall in prices on UK sales in the past three months, unchanged from the previous quarter. Reponses on export prices were also little changed over the quarter, with a net balance of 5% of companies cutting prices.

Price falls on domestic sales were concentrated in those sectors most exposed to the falling oil prices, including chemicals and rubber and plastics. Elsewhere in manufacturing there was little deviation from the average.

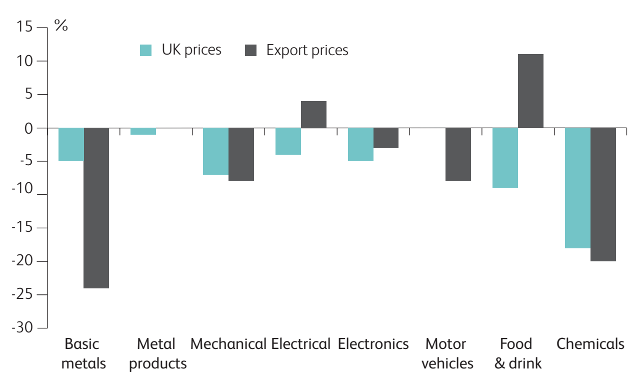
Our survey notes a slightly different trend in export prices. Chemicals manufacturers are again more likely to have reduced selling prices, and in addition, basic metals manufacturers have also cut prices – potentially in response to a strengthening Sterling exchange rate.

Expectations for pricing in the next three months appear more positive, with a small balance of companies planning to push through price increases on domestic sales (3%). The sectoral pattern of pricing expectations is little changed from this quarter, but smaller companies look more confident about securing price increases.

These pricing movements continue to feed through to squeezed margins across manufacturing. A balance of 4% of companies saw margins on UK sales fall in the past three months and 12% reported a decline in export margins. The motor vehicles sector stands out as the only sector in which there has been any significant sign of margin improvement over the quarter. This general weak trend in margins is not expected to change significantly in the next quarter.

CHEMICALS MOST LIKELY TO CUT PRICES

% BALANCE OF CHANGE IN PRICES IN THE PAST THREE MONTHS

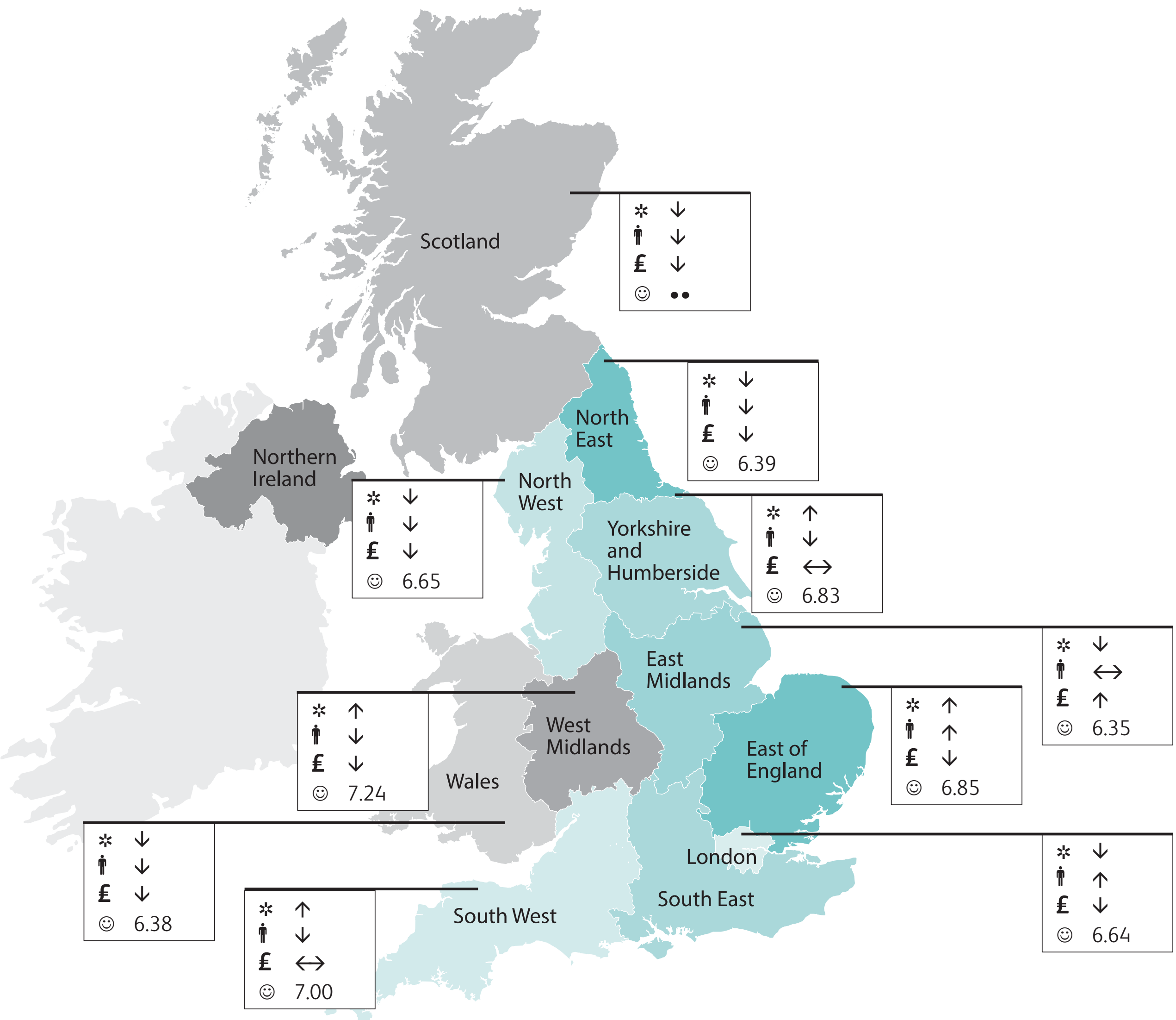


Source: EEF Business Trends Survey

REGIONAL TRENDS

Most regions report positive output balances over the past three months, but the effects of a drop in oil and gas activity have impacted on Scottish responses.

Employment growth is less evenly spread, with positive recruitment activity concentrated in the South West, West Midlands and Yorkshire and Humberside.



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER

✲ OUTPUT

EMPLOYMENT

£ INVESTMENT

☺ BUSINESS CONFIDENCE

Source: National Statistics

Positive output balances were reported almost everywhere, with the exception of Scotland and the North West. We can attribute the weaker balances in these regions to exposure to North Sea investment and a decline in activity in basic metals respectively. Responses across the country were more mixed on new order intake. Companies in the East of England and the South East and London recorded stronger export balances while there was more notable strength in domestic demand in the West Midlands and Yorkshire and Humberside.

Those regions noting stronger positive balances on new orders were also more likely to have seen more companies increasing employment over the past three months. In all regions, except the East of England and the South East and London, employment balances were lower than three months ago.

BUSINESS CONFIDENCE INDICATORS

Looking at the headline confidence indicators introduced to our survey this quarter, all regions are, on average, expecting to see an improvement in business conditions and activity in the UK economy over the next twelve months.

That said, there is some variation between regions with manufacturers in the West Midlands and the South West expecting slightly stronger improvements in business conditions in the year ahead than the rest of the country. Respondents in the East Midlands and the North East have below average business growth expectations for the next 12 months.

There is slightly less variation in expectations about economic improvement in the next year. While all regions are forecasting a modest improvement, companies in the North West report the weakest expectations.

IMPROVEMENTS IN BUSINESS GROWTH AND ECONOMY EXPECTED

CONFIDENCE IN THE NEXT 12 MONTHS 1 = SUBSTANTIALLY WORSE, 10 = SUBSTANTIALLY BETTER

Source: EEF Business Trends Survey

REGIONAL SUMMARY

% BALANCE OF CHANGE

SECTOR	OUTPUT PAST 3 MONTHS	OUTPUT NEXT 3 MONTHS	TOTAL ORDERS PAST 3 MONTHS	TOTAL ORDERS NEXT 3 MONTHS	EMPLOYMENT PAST 3 MONTHS	EMPLOYMENT NEXT 3 MONTHS	INVESTMENT PAST 3 MONTHS
Scotland	-16	9	-7	7	-4	11	11
North East	11	29	-5	22	21	11	11
North West	-6	27	-6	38	-12	12	9
Yorks & Humber	29	46	25	58	33	38	30
East Mids	8	14	-4	13	0	8	14
Eastern	40	34	33	28	10	17	21
South East & London	36	33	26	28	14	2	35
South West	18	19	0	18	22	9	5
West Mids	46	34	34	35	26	23	-6
Wales	29	29	14	29	14	14	0

ECONOMIC ENVIRONMENT

The UK grew by 2.6% in 2014, the fastest annual growth rate in the G7. After a very strong start to the year, a deterioration in global economic conditions during H2 2014 took its toll on the pace of UK economic growth. For the year ahead, a lower oil price and an accommodative monetary policy should help mitigate some of these headwinds by boosting consumer spending and investment to achieve a robust 2.8% GDP growth.

UK HEADLINES

– Economy grew by solid 2.6% in 2014
– Slowdown in H2 due to weakness in overseas markets
– Slump in oil price sparks deflationary pressures
– Robust 2.8% growth expected for 2015

Economic growth was broadly balanced in 2014 with all main industries – services, production and construction – making positive contributions to GDP. Nevertheless, growth was notably driven by demand in the domestic market and expansion in the production industries slowed in the latter half of the year. Geopolitical uncertainty in the Middle East and Ukraine as well as economic woes in the eurozone have dampened external demand for the export-intensive production sectors while an appreciation in the pound is also weighing on export competitiveness.

Growth in 2014q4 was thus dependent on services which achieved a record trade surplus in December 2014 to offset a record deficit on trade in goods. While this divergence should begin to smooth out in 2015 as the situation in the eurozone is projected to improve (contingent on avoiding a 'Grexit'), growth should continue to be driven by the services sector – set to grow by 3.1%. Manufacturing is expected to grow by a healthy 1.7% in 2015 but slow from 2.5% in the previous year.

UK ECONOMIC FORECASTS

% CHANGE EXCEPT WHERE STATED

	2013	2014	2015	2016
Trading environment				
Exchange rate (€/£)	1.18	1.24	1.39	1.47
Exchange rate ($/£)	1.56	1.65	1.48	1.47
Exports	1.5	-0.8	3.6	5.3
Imports	1.4	0.9	3.1	5.1
Current account (% GDP)	-4.5	-5.4	-4.6	-3.9
Output				
Manufacturing	-0.7	2.8	1.7	1.9
GDP	1.7	2.6	2.8	2.7
Costs and prices				
Average earnings	1.6	0.7	2.5	2.7
Oil price (Brent Oil $/bl)	108.7	99.1	54.7	64.1
Employment				
Manufacturing (000s)	2,557	2,590	2,593	2,572
Rest of economy (000s)	32,268	33,374	33,801	34,132
Unemployment rate (%)	7.5	6.1	5.4	5.2

Source: Oxford Economics and EEF

Private consumption grew by 2.3% in 2014 on the back of an improving labour market and a low inflation environment. In the labour market, slack continues to erode rapidly with unemployment down to 5.7% while real wage growth returned in 2014 aided by low inflation. The UK workforce saw the strongest increase in their real incomes since 2012 and this trend is expected to persist in 2015.

Low inflation is largely down to the massive slump in oil prices since June 2014. The global oil price fell by more than 50% as a supply shock, mainly from US shale, came to complement sluggish global demand. These pressures took UK inflation to 0.3% in the year to January. While the BoE expects negative inflation in certain months of 2015, it has underplayed the dangers of persistent deflation as price pressures reflect external factors rather than UK consumer confidence, keeping mid-term inflation expectations anchored to around 2%.

The full impact of lower oil prices should feed through this year giving a significant boost to consumer spending which is projected to continue to be a key driver of growth. On the other hand, the North Sea oil & gas extraction sector is set to take a big hit and evidence of the cancellation of projects is already surfacing. The sector, which accounts for a significant portion of business investment in the UK, is expected to make big cuts to capital expenditure in 2015.

Business investment rebounded strongly in 2014, increasing by approximately 6.6 % over the year. However, uncertainty about developments in the eurozone and the performance of major developing economies could mean a slackening in the pace of growth for business investment in 2015. Uncertainty in key markets also adds to a weak export outlook, with trade not expected to make substantial contributions to growth in the year ahead.

GLOBAL HEADLINES

- IMF cuts global growth forecast to 3.5 % in 2015
- Eurozone marred in uncertainty
- Major emerging economies face slowdown
- Investment weakness to be partially offset by lower oil prices

The global economy grew by 3.3 % in 2014 – considerably lower than the 3.7 % predicted by the IMF at the beginning of the year. Growth was tempered by the emergence of geopolitical uncertainty in the Middle East and Ukraine, persisting troubles in the eurozone, as well as a slowdown in major emerging economies – most notably China.

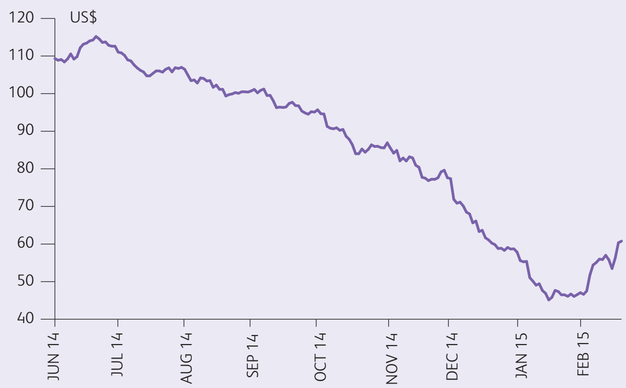
OIL SPOTLIGHT

The oil price slump which started in June 2014 caught the world by surprise. Since then, the Brent crude oil price has fallen by around 50 %, fluctuating around $55 p/b in February. The short-term cause for the drop in the oil price was a mismatch in supply and demand as expectations for disruptions in production in the Middle East failed to materialise in combination with sluggish global demand.

The long-term structural factor is the supply shock from US shale gas production propping up the global stock of oil. During the course of 2014, the 'shale boom' propelled the US to record high levels of oil production. The correction in the oil price has halted the rapid pace of growth in higher-cost US shale but production is still anticipated to grow solidly in 2015. Analysts expect the oil market to balance at around the $60-70 p/b mark.

BRENT CRUDE OIL PRICE HALVED

EUROPE BRENT SPOT PRICE FOB (DOLLARS PER BARREL)



Source: EIA

The IMF now expects the global economy to grow by 3.5% in 2015 from the previous projection of 3.8%; EEF forecasts a slightly weaker profile at 3.3%. Two major developments are likely to shift global growth in the year ahead to above or below the baseline scenario; the oil price and the eurozone crisis. In addition, divergence between the performances of major economies is expected to continue to be the underlying trend for the year ahead.

During the course of 2014, there was marked divergence in the performance mainly of the UK and US on the one side and Japan and the eurozone on the other. This is likely to be a key theme in 2015 too. Advanced economies – which are in the majority oil importers – are set to receive a boost from the lower oil price. However, this is unlikely to fully offset investment weakness as most developed economies adjust to lower medium-term growth expectations and persistently sluggish demand.

In emerging markets, the slowdown in China is the main story with adverse regional and global effects. In Asia, forecasts for most economies have been downgraded as a result, including India. A lower oil price should boost Asia's two largest emerging economies but demand shortfalls are likely to constrain the positive impact. Conversely, major oil exporters in the Gulf, Latin America and Africa will struggle to balance their budgets and growth there is expected to cool substantially. Russia, which in addition to the low oil price also faces EU sanctions, is heading for a deep recession.

The probability of a lower oil price providing a bigger boost than expected attaches an upside risk to the global growth forecast. By contrast, the renewed crisis in the eurozone could tip the scales on either side. A potential 'Grexit' would send shockwaves throughout the globe and possibly plunge the eurozone back into recession or close-to-zero growth.

Alternatively, a definitive solution to the eurozone crisis would reinstate confidence in markets and kick-start growth in the region. The timing is also crucial; a protracted period of negotiations is likely to be detrimental for investment and demand, leaving less room for growth in 2015.

INTERNATIONAL ECONOMIC FORECASTS

% CHANGE EXCEPT WHERE STATED

	GDP			INFLATION		
	2014	**2015**	**2016**	**2014**	**2015**	**2016**
France	0.4	1.2	1.7	0.5	0.3	1.0
Germany	1.6	2.2	2.0	0.9	-0.1	1.5
Japan	0.1	0.9	1.8	2.7	0.3	0.6
US	2.4	3.1	2.8	1.6	0.3	2.2
Eurozone	0.9	1.6	1.8	0.4	-0.2	1.1
China	7.4	6.8	6.1	2.0	1.3	1.6
India	5.3	6.3	6.4	7.2	5.5	6.2
World (2010 PPPs)	3.2	3.3	3.8	3.2	1.8	2.6

Source: Oxford Economics

EURO SLIDES AS 'GREXIT' UNCERTAINTY MOUNTS

EURO/USD EXCHANGE RATE, DAILY FEB 2014 – FEB 2015

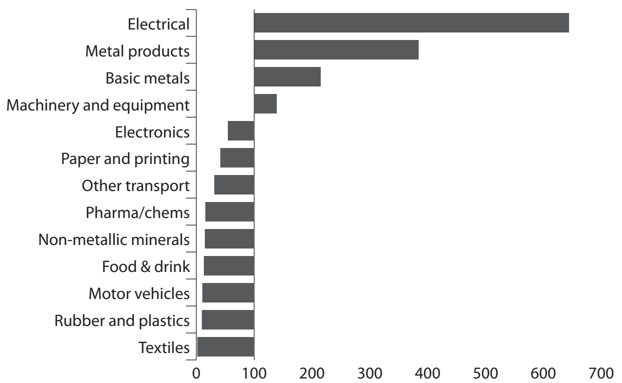
Source: EEF Business Trends Survey and ONS

SECTOR FORECASTS

A dip in the oil price presents something of a mixed picture for manufacturing. There are three key channels through which the oil price will affect sectors: an increase in consumer spending; reduced input prices; and reduced demand in oil and gas sectors.

EXPOSURE TO OIL AND GAS SECTOR LIKELY TO IMPACT GROWTH PROSPECTS

PROPORTION OF OUTPUT TO OIL AND GAS SECTORS (INDEX, MANUFACTURING = 100)



Source: EEF and ONS

AN INCREASE IN SPENDING POWER SHOULD SUPPORT GROWTH IN CONSUMER-FOCUSED SECTORS

One key way in which the oil price will benefit manufacturers is through its likely impact on consumer spending, both in the UK and overseas. For example, **motor vehicles** should benefit from a slow but steady turnaround in European consumer spending at the same time as new models come on line. We are forecasting growth of 4.4%.

Similarly, **food and drink** is highly consumer-focused, and has a strong link to the domestic economy, both factors should support growth in the year ahead. However, this sector is also being squeezed by price wars and restructuring in the supermarket sector. As a result we expect growth to continue, but at a slower pace of 2.2% in 2015, compared with 4.9% in 2014.

Textiles is the most consumer-facing of the UK manufacturing sectors, with over three quarters of final output going to households, meaning stronger consumption could provide a boost for some companies. However, this has to be weighed against the picture for the sector as a whole, which continues to experience a long-term decline. Following large falls in output in the second half of 2014, we expect output to fall 6.9% in 2015.

The **non-metallic minerals** sector may benefit somewhat from a stronger consumer, though more important for this sector is that demand will be sustained by a broadening out of growth in construction beyond private house building towards areas such as commercial offices and new infrastructure. Nonetheless, growth is unlikely to continue at last year's pace, we are forecasting a 1.9% increase in output this year.

LOWER INPUT PRICES SHOULD PROVIDE A BOOST FOR CHEMICALS AND PLASTICS

For some sectors the falling oil price will lead to a fall in input prices. The fall in the oil price should provide a boost to demand for **rubber and plastics**, which relies on oil based products for inputs and should see a good 2015 anyway, supported by construction and motor vehicles. We have revised our forecast for this sector up slightly in 2015, from 2.0% to 2.5%.

The **chemicals** sector should also see falling input prices, which may go some way to counteract the impact of challenges facing the pharmaceutical industry that led to a contraction in 2014. As a result, we expect output to increase, but by a modest 0.3%.

REDUCED DEMAND IN OIL AND GAS SECTOR IS LIKELY TO HIT COMPANIES IN THE SUPPLY CHAIN

Lower oil prices are not universally good news and are already proving a challenge for manufacturers in the oil and gas supply chain. Most notably the **electrical equipment** sector is likely to suffer as oil and gas projects are postponed or cancelled. While there are some positive stories in this sector that should balance this out – such as major infrastructure projects coming on stream – the fall in demand from oil and gas is likely to mean that output in this sector drops by 1.5% in 2015.

SECTOR FORECASTS

Some **basic metals** manufacturers will also be hit by a fall in demand for the oil and gas sector – with demand for products such as metal pipes used in pipelines particularly vulnerable. This will add to challenges currently being felt by this sector as a result of the stronger Sterling and we expect output to fall 4.8% in 2015, after falling by 3.8% in 2014.

Growth in **mechanical equipment** is also closely linked to oil and gas expenditure, and although the sector should benefit from growing investment expenditure, the outlook for UK orders is one of continued contraction. Our forecasts for the sector are therefore modest. We expect growth of 0.8% in 2015.

There has been a similar dip in UK orders for **metal products** manufacturers in the oil and gas supply chain. However, as this sector has a diverse customer base, with growth dependent on a broad range of sectors within manufacturing, the demand outlook for this sector is more mixed. We expect output to grow by 1.5%, a similar pace to the manufacturing as a whole in 2015.

THE OIL PRICE WILL NOT BE A DRIVING FORCE FOR ALL SECTORS

Growing investment expenditure should support improvement in the **electronics** sector, as its key export markets – notably the US – look set to perform well and we have revised our forecast up from 4.2% to 5.0% in 2015.

After output in **other transport** fell in 2014, we expect to see a return to growth in 2015. The sector continues to benefit from long-term orders, however, momentum in the sector has clearly slowed, and we expect growth of 5.0%, unchanged from last quarter's forecast.

The **paper and printing** industry continues to face challenges associated with over capacity and long-term shifts in consumption. However, the sector has seen some consolidation of late, which should support moderate growth. The sector may also benefit from additional promotional activity surrounding the general election.

SECTOR GROWTH RATES AND FORECASTS

% CHANGE

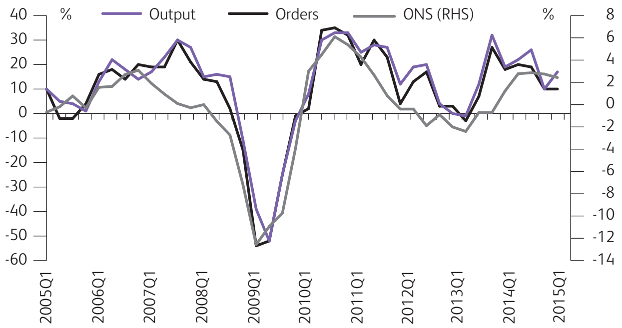
	OUTPUT			EMPLOYMENT		
	2014	2015	2016	2014	2015	2016
Basic metals	-3.8	-4.8	-1.5	2.6	-2.8	-3.0
Metal products	2.4	1.5	1.9	0.1	0.4	-0.1
Mechanical	3.0	0.8	4.8	3.1	0.2	0.2
Electronics	4.1	5.0	2.6	-2.2	-7.3	-1.1
Electrical	-2.7	-1.5	1.6	-4.6	3.8	-0.5
Motor vehicles	9.1	4.4	3.4	-0.7	2.0	1.7
Other transport	-0.8	5.0	3.3	4.1	2.8	0.5
Food and drink	4.8	2.2	0.9	2.6	-0.5	-1.3
Chemicals	-0.7	0.3	1.5	8.2	0.1	-2.9
Rubber and plastics	11.6	2.5	1.8	4.2	-0.1	1.9
Non-metallic minerals	15.4	1.9	2.4	-2.1	6.6	1.8
Paper and printing	-0.6	0.9	0.0	8.8	-1.6	-2.5
Textiles	-4.2	-6.9	-2.5	-2.9	-4.6	-9.9
Manufacturing	2.8	1.7	1.9	1.3	0.1	-0.8

Source: EEF and Oxford Economics

HISTORIC MANUFACTURING TRENDS

OUTPUT STILL GROWING

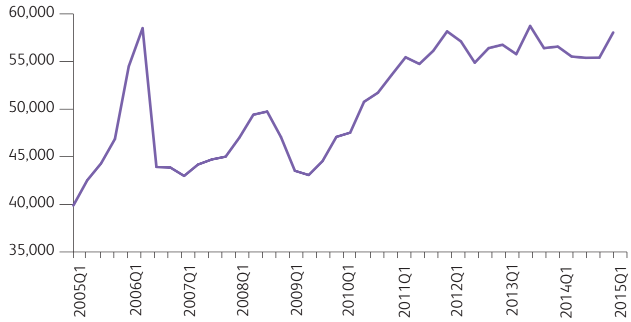
% BALANCE OF CHANGE IN THE PAST THREE MONTHS AND % CHANGE ON A YEAR AGO



Source: EEF Business Trends Survey and ONS

IS EXPORT GROWTH ABOUT TO TAKE OFF?

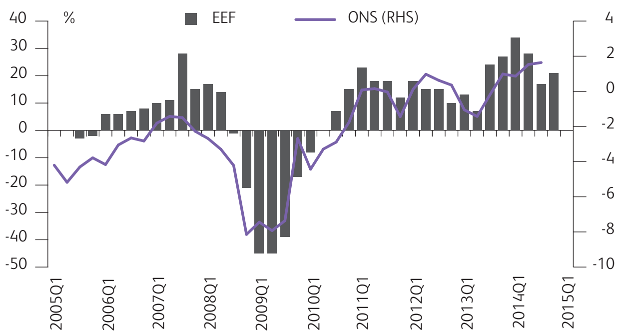
MANUFACTURED EXPORTS, VALUE (£M)



Source: ONS

MANUFACTURING EMPLOYMENT STILL RISING

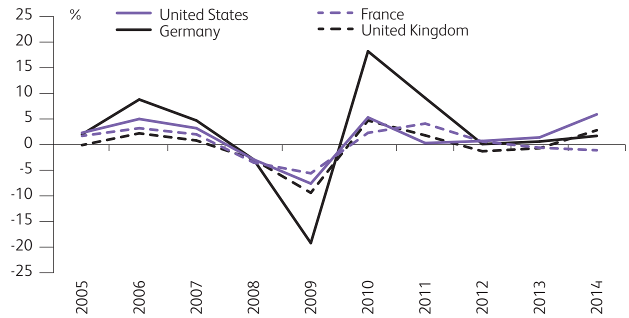
% BALANCE OF CHANGE IN THE PAST THREE MONTHS AND % CHANGE ON A YEAR AGO



Source: EEF Business Trends Survey and ONS

UK SEES A STRONG MANUFACTURING PERFORMANCE IN 2014

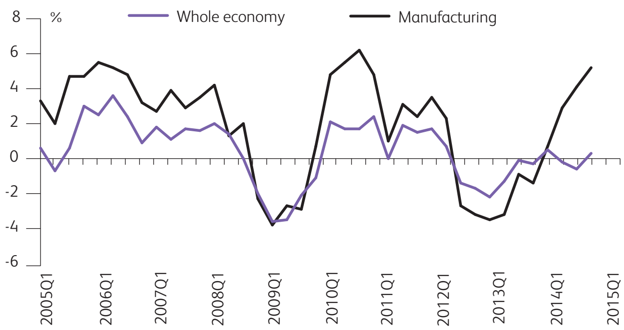
MANUFACTURING GVA, ANNUAL % CHANGE



Source: OECD

MANUFACTURING PRODUCTIVITY GROWTH OUTPACES WHOLE ECONOMY IN 2014

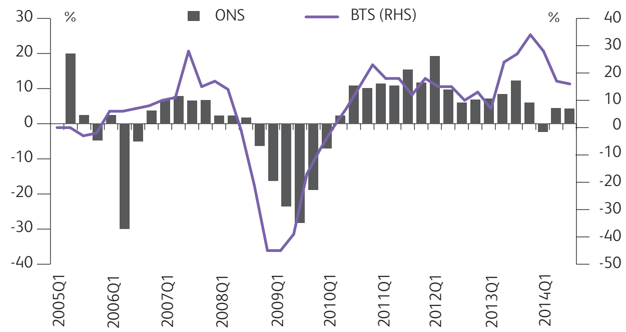
OUTPUT PER HOUR, ANNUAL % CHANGE



Source: EEF Business Trends Survey and ONS

INVESTMENT IN MANUFACTURING RECOVERS STRONGLY

% BALANCE OF CHANGE IN THE PAST THREE MONTHS AND % CHANGE ON A YEAR AGO



Source: EEF Business Trends Survey and ONS

ABOUT EEF

EEF is dedicated to the future of manufacturing. Everything we do is designed to help manufacturing businesses evolve, innovate and compete in a fast-changing world. With our unique combination of business services, government representation and industry intelligence, no other organisation is better placed to provide the skills, knowledge and networks they need to thrive.

We work with the UK's manufacturers from the largest to the smallest, to help them work better, compete harder and innovate faster. Because we understand manufacturers so well, policy makers trust our advice and welcome our involvement in their deliberations. We work with them to create policies that are in the best interests of manufacturing, that encourage a high growth industry and boost its ability to make a positive contribution to the UK's real economy.

Our policy work delivers real business value for our members, giving us a unique insight into the way changing legislation will affect their business. This insight, complemented by intelligence gathered through our ongoing member research and networking programmes, informs our broad portfolio of services; services that unlock business potential by creating highly productive workplaces in which innovation, creativity and competitiveness can thrive.

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The data used in this survey has been provided by EEF members. 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 Amanda Norris in our Information and Research team anorris@eef.org.uk

ABOUT DLA PIPER

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