



The
manufacturers'
organisation

In partnership with:



MANUFACTURING OUTLOOK

2015 QUARTER 4



2.6 million
employees



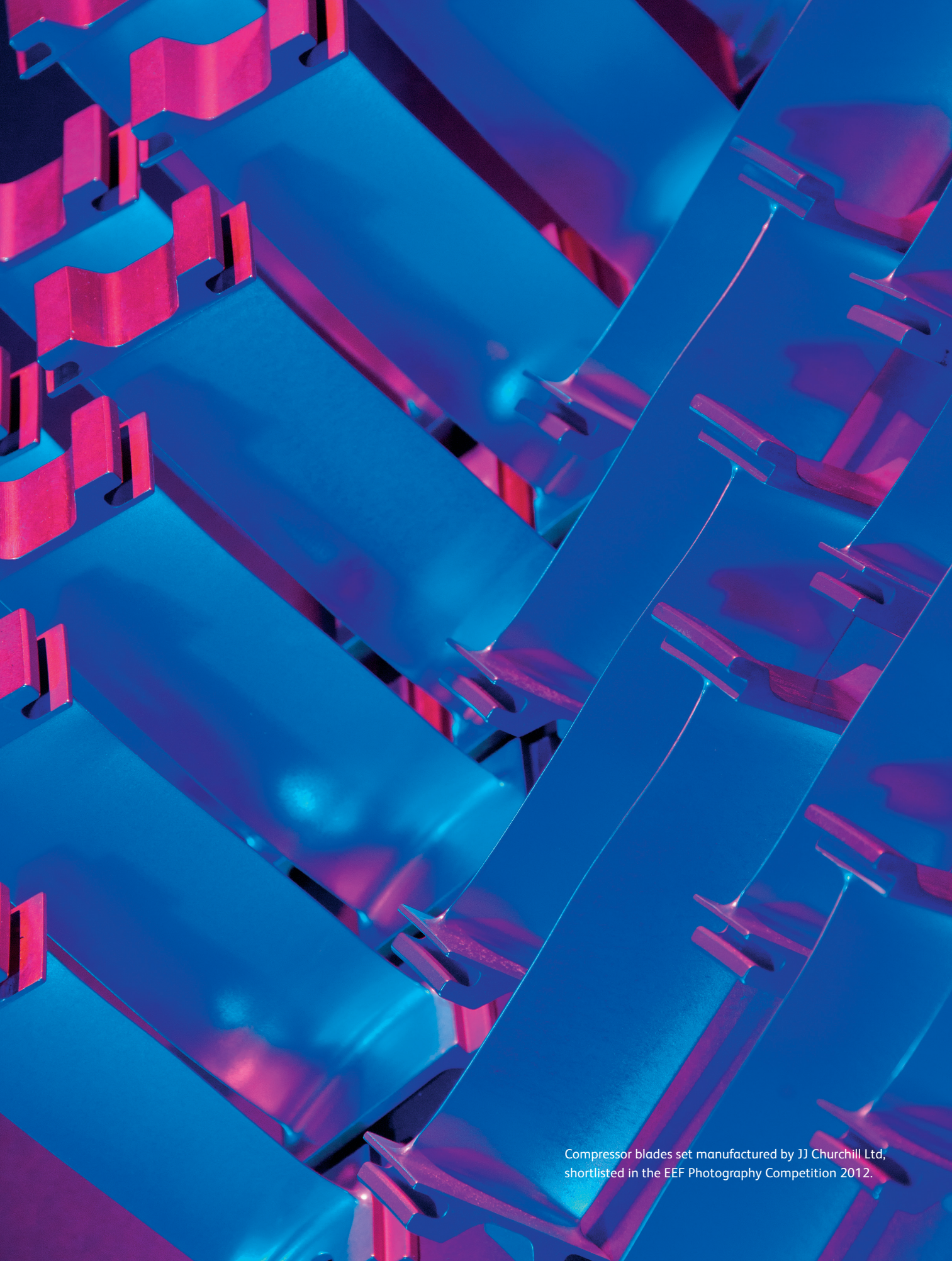
1/2 of UK
exports



72% of business
R&D



Average wages higher
than the rest of the
economy



Compressor blades set manufactured by JJ Churchill Ltd,
shortlisted in the EEF Photography Competition 2012.

FOREWORD



Lee Hopley
Chief Economist
EEF



Richard May
Head of Manufacturing
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Welcome to the 2015q4 *Manufacturing Outlook* report in partnership with DLA Piper.

Last quarter we signalled that storm clouds were gathering on the horizon, and in the past three months it seems that the gloom – mainly from events in the global economy – has settled over more of the UK’s manufacturing sectors.

This quarter we see significant weakening across most of the major components of our survey, confirming that after a big step forward in growth terms in 2014, industry has taken a step back this year.

Concerns about world trade growth and the strength of demand from both developed and emerging markets have become more prominent in the headlines since our last report. And these concerns seem justified in the face of the decline in export orders and rise in the proportion of companies unable to pinpoint any parts of the world experiencing an improvement in demand conditions.

Closer to home, the domestic market is also looking considerably less supportive than has been the case in recent years. Indeed the fall in sentiment about UK orders compared with the previous quarter is the steepest since 2008q4.

Our survey balances throughout the year have put a spotlight on the hardest hit sectors – basic metals and mechanical equipment – but, it has been the unfolding events in the UK’s critical steel sector that have really brought home the scale of these and other challenges. However, the decline in activity has become more widespread over the quarter, with only the food and transport sectors pushing balances in a more positive direction.

While medium term confidence has waned it has not collapsed. However, investment and employment balances have tipped into the red for the first time since the start of 2010. This was a risk we have been alive to since the output and orders indicators started softening earlier this year. We continue to see some growing downside risks to a continuing recovery in business investment over the coming quarter.

The key takeaways from our final report in 2015 are therefore quite different from where we started in March. Overall output across the sector is now expected to post a marginal contraction. And it is against this backdrop that we judged the government’s recent Spending Review and Autumn Statement to have struck a good balancing act of trying to improve public finances while taking steps to boost productivity and long-term growth.

2015Q4 HEADLINES

The final months of 2015 mark the third consecutive quarter in which we have reported a fall in the key output and orders balances in our survey, all of which stand firmly in negative territory. Up until now, however, deterioration

in the short term indicators has not fed through to more widespread weakening in confidence – that has changed in our latest report.

INDICATOR	BALANCE	CHANGE	
Confidence	5.1	↓	Confidence about the UK economic outlook dips for the year ahead
Output	-12%	↓	Output balances records sharpest dip since 2014q3
UK orders	-19%	↓	UK orders responses hit lowest level since 2009q3
Export orders	-19%	↓	Weaker world trade growth keeps exports in negative territory
Employment	-7%	↓	Employment balance falls, but not in every manufacturing sector
Investment	-3%	↓	First negative capex balance since 2010q1

Source: EEF Business Trends Survey

As the table above starkly highlights, all the main indicators in our survey have taken another turn for the worse over the past three months. If we look only at where the levels have settled over the past quarter, we would need to go back to 2009 to find lower balances on the output and orders questions.

However, it is probably more instructive to compare relative movements in the balances from the preceding quarter. On this measure, the decline in the output balance is the most significant since 2014q3 – the immediate aftermath of the collapse in the oil price. Likewise drops of similar magnitudes in the UK and export orders balances (nine percentage points), have not been uncommon in the past two years.

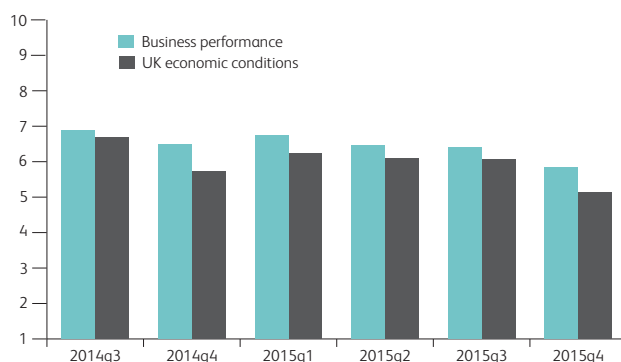
While the results of our latest survey reinforce the view that manufacturing is facing some significant challenges. They do not necessarily signal that those challenges have ramped up to a great extent over the quarter.

Indeed, looking at the sector results, those that have been hardest hit by falls in oil and gas investment and slower world trade growth – metals, mechanical and electrical equipment – remain the most downbeat about prospects over the quarter.

That said, wider confidence about business conditions and the UK economy over the next 12 months has dipped, leading to net falls in both employment and investment plans. This would confirm a more cautious take on the negative forward-looking output and orders balances in our survey and has contributed to our forecast downgrades for manufacturing in 2016.

CONFIDENCE ABOUT THE UK OUTLOOK FALLS SHARPLY

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



Source: EEF Business Trends Survey

OUTPUT

The output balance went deeper into the red in 2015q4 and at -12% posted the weakest print since 2009q3. This was the last time when the output balance turned negative for two consecutive quarters. This weakness has also fed in to forward looking indicators, with manufacturers expecting a drop in output over the next quarter. While the decline in the output balance is not the sharpest in our recent surveys, it indicates that existing challenging conditions are becoming further entrenched for the UK manufacturing sector.

PAST THREE MONTHS	↓	-12%
NEXT THREE MONTHS	↓	-7%

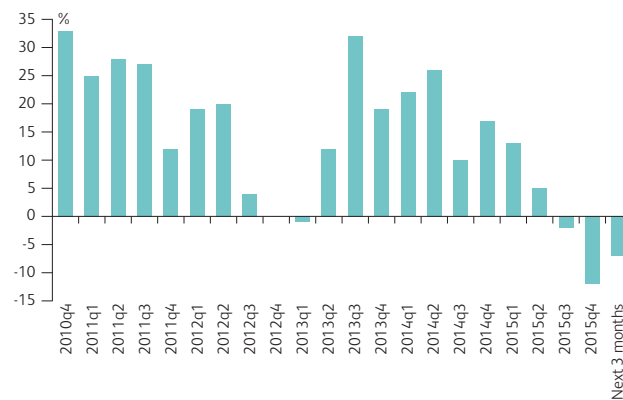
Output balances have been on a downward slope from 2014q4. Headwinds for the manufacturing sector have been piling on ever since, with the slump in the oil price hurting manufacturers in the oil and gas supply chain and a slowdown in key emerging markets taking the steam off export demand. With global trade expected to remain subdued and oil and gas capital expenditure unlikely to stage a comeback in 2016, expectations for output growth in the next quarter have taken a serious hit.

In contrast to previous quarters where the weakness was concentrated on sectors supplying to the North Sea, chiefly mechanical equipment, output balances have now weakened across most sectors. The downside surprise from construction activity in q3 has put a dent in the growth of the non-metallic minerals and rubber and plastics sectors, while steel plant closures have meant a collapse in basic metals output.

Still, the weakness is not universal, with the transport sectors a persistent bright spot in our survey. The motor vehicles sector in particular continues to grow strongly on the back of robust consumer demand and the introduction of new models. What is more, prospects for the chemicals and pharmaceuticals industries are looking positive, with a drop in input costs for the former and the end of the patent cliff for the latter, driving growth in these sectors.

OUTPUT BALANCE CONTRACTS FOR SECOND CONSECUTIVE QUARTER

% BALANCE OF CHANGE IN OUTPUT



Source: EEF Business Trends Survey

OUTPUT SUMMARY

% BALANCE OF CHANGE

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
Basic metals	-31	-31
Metal products	0	-13
Mechanical	-21	-7
Electrical	-26	5
Electronics	-5	-3
Motor vehicles	44	33
Other transport	-8	27

TURNOVER

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
£0-9m	-14	-6
£10-24m	1	1
£25m and over	9	-2

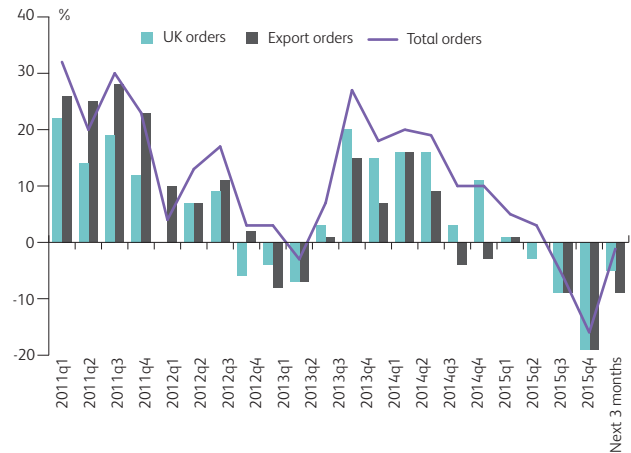
Source: EEF Business Trends Survey

ORDERS

Total orders remained on a downward trajectory in q4, falling further into negative territory to the weakest in more than five years. Both UK and export orders balances came in at -19%, indicating demand from both the domestic market and abroad continued to deteriorate. The poor intake in orders in q4 has dampened expectations for the next three months and a further weakening is expected, particularly in export orders.

ORDERS AT THEIR WEAKEST IN MORE THAN FIVE YEARS

% BALANCE OF CHANGE IN ORDERS



Source: EEF Business Trends Survey

UK ORDERS	PAST 3 MONTHS	↓	-19%	NEXT 3 MONTHS	↓	-5%
EXPORT ORDERS	PAST 3 MONTHS	↓	-19%	NEXT 3 MONTHS	↓	-9%
TOTAL ORDERS	PAST 3 MONTHS	↓	-16%	NEXT 3 MONTHS	↓	-1%

UK ORDERS

UK orders have continued to weaken despite solid headline economic growth. Yet again, a key driver of the deterioration has been manufacturing sectors embedded in the oil and gas supply chain. The mechanical equipment sector has been particularly weak, highlighting that the low crude oil price has put a halt to investment in North Sea. Mechanical equipment orders were negative throughout 2015, with significant falls in the second half.

Similarly, orders in the electrical equipment and basic metals sectors have been dragged down by their exposure to the North Sea. Electrical equipment orders declined significantly in the second half of the year after a reasonable performance earlier in the year. Orders for basic metals resumed falling after moving sideways in q3.

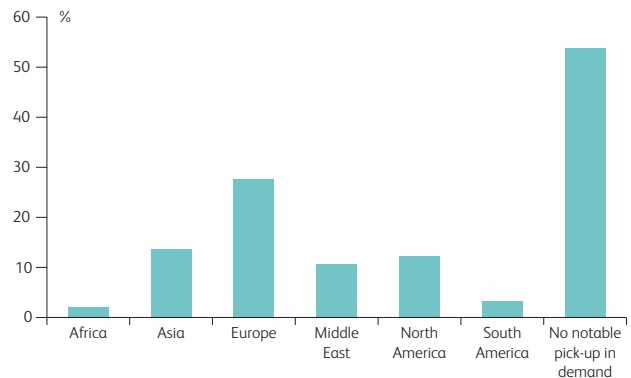
In contrast, the drag on inflation from the low oil price, along with the improving UK labour market, have supported orders in consumer-facing sectors. Motor vehicles saw orders strengthen thanks to stronger real wage growth and lower unemployment. Likewise, food

and beverage orders picked up, helped by low inflation supporting households' purchasing power.

Overall, manufacturers expect UK orders to deteriorate further in the next three months but by less than they did in q4.

EUROPE IS THE MAIN REGION REPORTING HIGHER DEMAND

% OF COMPANIES REPORTING IN CHANGE IN DEMAND BY MARKET



Source: EEF Business Trends Survey

EXPORT ORDERS

Global economic growth has weakened over the course of this year, dragging on world trade. Consequently, export orders declined sharply in q4 for the second consecutive quarter to the weakest in more than five years. Slower economic growth in emerging markets such as China has weighed on orders for UK exports. Also, the rebalancing of China's growth drivers toward private consumption and away from investment has dampened demand for investment-related goods such as mechanical equipment. Furthermore, the strong sterling continues to dampen demand for exports in commoditised sectors such as basic metals. Europe remains the main source of demand for UK exports, even though our q4 survey results indicate it has recently waned somewhat.

Meanwhile, the motor vehicle and chemical sectors are the main bright spots. The US and Europe remain steady source of demand for both sectors. For the most part, however, manufacturers reported no notable pick up in demand.

Manufacturers expect overseas sales will remain subdued in the first quarter of 2016. Export orders are expected to weaken further but the pace of the deterioration is smaller than what was experienced in q4, suggesting that overseas demand may be starting to stabilise.

SALES PERFORMANCE

Manufacturers reporting that they are behind in their year-to-date sales performance has risen in every quarter of 2015. Sales in the other transport sector were the most behind target, indicating the volatility in order flow in this sector. In contrast, sales in the food and drink sector were least behind target, highlighting the strength of the consumer-facing sectors.

At the same time, manufacturers reporting they are in line with, or ahead of, their year-to-date sales performance has fallen over the same period. The electronics sector outperformed in relation to being in line with – and ahead of – target, indicating that stronger real wage growth and lower unemployment has supported demand for consumer durables.

ORDERS SUMMARY

% BALANCE OF CHANGE

SECTOR	UK ORDERS		EXPORT ORDERS		TOTAL ORDERS	
	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Basic metals	-20	-24	-39	-35	-31	-31
Metal products	-9	-20	-11	-13	-8	-12
Mechanical	-36	0	-30	-3	-27	8
Electrical	-26	-16	-5	-5	-26	-16
Electronics	-5	14	-19	-10	-11	11
Motor vehicles	38	50	14	43	44	56
Other transport	-42	9	-9	-9	-33	-9
TURNOVER						
£0-9m	-21	-8	-23	-9	-17	-3
£10-24m	-12	1	0	2	-13	5
£25m and over	2	4	0	2	0	5

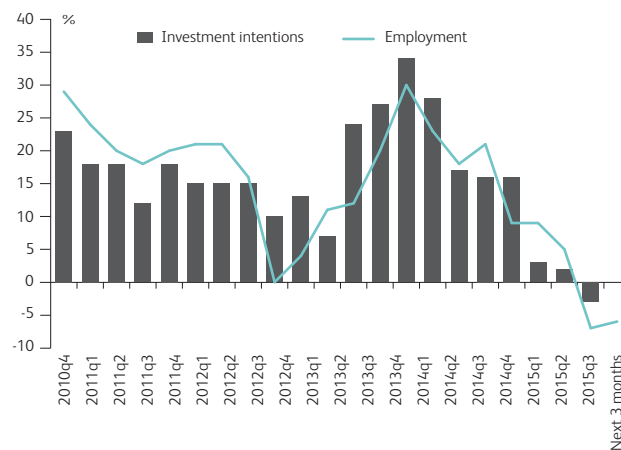
Source: EEF Business Trends Survey

EMPLOYMENT & INVESTMENT

The downturn in the manufacturing sector over 2015 has now taken its toll on manufacturers' plans to recruit staff and up their capital expenditure. These two indicators have proved incredibly resilient over the past five years despite fluctuations in our other key balances. This resilience has now ended, with both balances dipping below zero in q4 for the first time since q1 2010.

UNCERTAINTY IN GLOBAL MARKETS TAKES ITS TOLL ON MANUFACTURERS' INVESTMENT INTENTIONS

% BALANCE OF CHANGE



Source: EEF Business Trends Survey

EMPLOYMENT	PAST 3 MONTHS	↓	-7%	NEXT 3 MONTHS	↑	-6%
INVESTMENT	NEXT 12 MONTHS	↓	-3%			

The gradual deterioration in output and orders over the past year has naturally affected manufacturers' plans for recruitment and investment. The weakness in the employment balance in q4 is concentrated on manufacturers in the oil and gas and construction supply chains. Electrical and mechanical equipment for the former, and rubber and plastics and non-metallic minerals for the latter, are looking to reduce staff in response to a large drop in domestic orders.

The well-publicised closure of iron and steel plants has also meant a significant reduction in headcount for manufacturers in the metals sectors. Metals are also the key drag in the negative investment balance, with the basic metals sector reporting a -22% outturn, the weakest in our survey. For the rest of manufacturing the picture is more nuanced.

The transport sectors continue to invest strongly, while the food and drink and chemicals sectors have joined the chorus since 2015q2. Perhaps surprising is the relative resilience of the mechanical equipment sector which reported a flat balance despite hefty drops in output and orders. This is because manufacturers in engineering sectors will tend to invest counter-cyclically to maintain

the productivity of their capital. Still, the negative total balance is an indication of elevated headwinds in global markets, with the resulting uncertainty weighing on the confidence of manufacturers to invest.

EMPLOYMENT AND INVESTMENT SUMMARY

% BALANCE OF CHANGE

SECTOR	EMPLOYMENT		INVESTMENT
	PAST 3 MONTHS	NEXT 3 MONTHS	NEXT 12 MONTHS
Basic metals	-15	-23	-22
Metal products	-8	-11	-6
Mechanical	-1	-5	0
Electrical	-32	-11	-12
Electronics	0	5	-9
Motor vehicles	22	44	44
Other transport	0	0	9
TURNOVER			
£0-9m	-6	-7	-8
£10-24m	1	9	7
£25m and over	-3	-9	-2

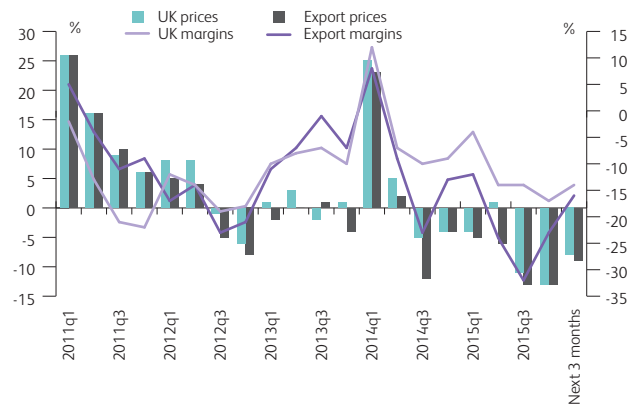
Source: EEF Business Trends Survey

PRICES & MARGINS

Factory gate price inflation has picked up but remains weak, with official data showing core output prices – excluding volatile food, drink and petroleum – increasing by 0.3% in the year to October. Our latest survey reveals price pressures remain subdued, with the balance on UK prices falling further into negative territory in the past three months. The balance on export prices dropped in q4 but by the same magnitude as in the previous quarter. At the same time, the balance of companies seeing a decrease in UK margins was larger than in last quarter but fewer companies reported a deterioration in export margins over the past three months.

EXPORT MARGINS STILL UNDER PRESSURE

% BALANCE OF CHANGE



Source: EEF Business Trends Survey

UK PRICE	PAST 3 MONTHS	↓	-13%	NEXT 3 MONTHS	↓	-8%
EXPORT PRICE	PAST 3 MONTHS	↔	-13%	NEXT 3 MONTHS	↑	-9%
UK MARGINS	PAST 3 MONTHS	↓	-17%	NEXT 3 MONTHS	↓	-14%
EXPORT MARGINS	PAST 3 MONTHS	↑	-23%	NEXT 3 MONTHS	↑	-16%

The balance of companies that reported increased prices on UK sales remained negative over the past three months, and at -13% was a deterioration on last quarter’s balance of -11%. The main downward price pressure was in basic metals, as lower input costs flowing from weak global commodity prices have kept a lid on price rises. Also, prices for mechanical equipment were weak thanks to the weakness of investment in the oil and gas sector.

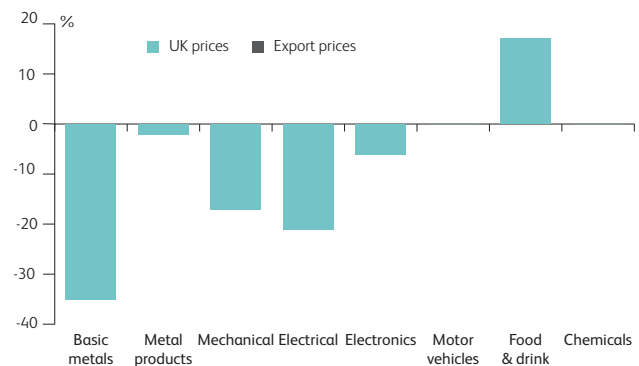
The picture on prices on export sales is unchanged from q3, with an overall balance of 13% of manufacturers reporting falling prices for the second quarter in a row. By sector, the largest declines were in basic metals, non-metallic minerals, and electrical equipment.

The squeeze on export margins has eased over the past three months thanks to the stabilisation of the falls in export prices. A balance of 23% of companies reported a decline in export margins, compared to a balance of 32% in the previous quarter.

The economic recovery in the eurozone, which contains key destinations for UK exports, along with the solid US economic growth is likely to have contributed to the improvement in export margins. Yet manufacturers remain pessimistic about the prospects for widening profit margins, particularly from UK sales, in the next three months.

BASIC METALS SECTOR FEELS THE SQUEEZE

% BALANCE OF CHANGE IN EXPORT MARGINS IN THE PAST THREE MONTHS

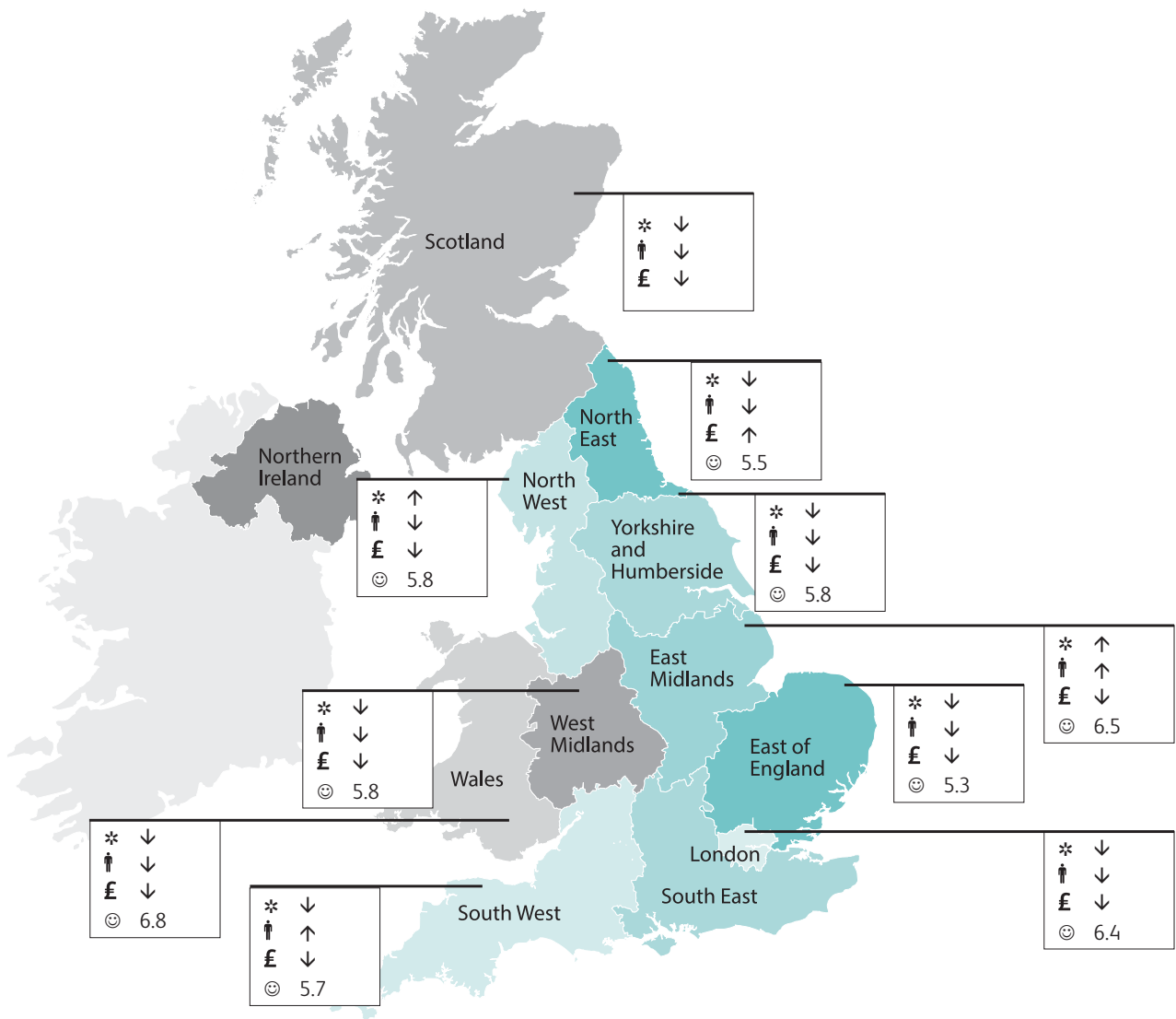


Source: EEF Business Trends Survey

REGIONAL TRENDS

The more challenging environment for manufacturing has been felt across UK regions. The majority of regions are reporting significant drops in output and orders, both

for the past and next three months. Employment and investment intentions are being pushed back as a result.



KEY:
 ↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
 * OUTPUT
 👤 EMPLOYMENT
 £ INVESTMENT
 😊 BUSINESS CONFIDENCE

Source: National Statistics

The weakness in the results is spread more evenly across regions compared to q3 Outlook. Eight out of ten regions have seen output balances drop in the past three months relative to the previous quarter, while six out of ten regions expect output to contract in the next quarter.

The outlook for orders is also weak. Seven out of ten regions have reported negative orders balances for the past three months. The weakness in domestic orders has spread more widely across the UK, but the lowest balances are still concentrated in regions supplying to the oil and gas industry, chiefly Scotland and the North East. Export balances have also tailed off further, with only Wales and the South West seeing a significant boost compared to q3.

Expectations for total demand in the next quarter are somewhat better, with results evenly split between those regions that expect growth and those that do not.

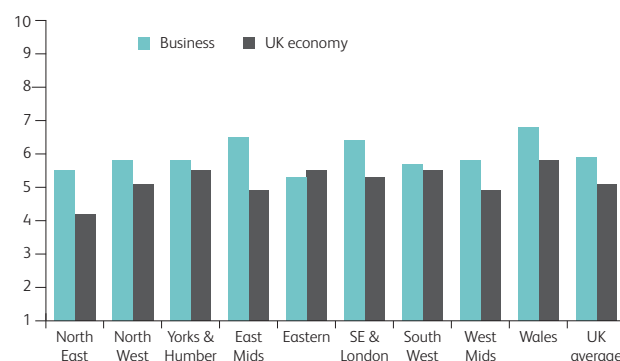
BUSINESS CONFIDENCE INDICATORS

A tougher picture for output and orders has naturally put a dent in regional confidence. Only Wales and the East Midlands are more confident about their business prospects compared to q3, while all regions are more negative about the UK economy.

This has been reflected in regional plans for recruitment and investment. Manufacturers in six out of ten regions are planning to scale back recruitment over the next three months, while only the South East and London is planning to up its capital expenditure.

REGIONS OPTIMISM WANES AS CHALLENGES MOUNT ON MANUFACTURING

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



Source: EEF Business Trends Survey

REGIONAL SUMMARY

% BALANCE OF CHANGE

SECTOR	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	-21	-2	-20	2	-9	-7
North East	-50	-47	-44	-35	-6	-29
North West	0	-10	-14	-7	-21	-24
Yorks & Humber	6	12	0	18	11	15
East Mids	11	-14	-14	19	14	-7
Eastern	-8	3	-11	3	-3	6
South East & London	36	25	19	11	6	6
South West	-14	-23	-31	-11	-7	-7
West Mids	-8	-15	-12	-9	-10	0
Wales	43	0	7	-14	-14	-8

ECONOMIC ENVIRONMENT

UK economic growth eased to 0.5% in the third quarter, from 0.7% previously. The main growth driver was fixed investment, followed by private consumption. Manufacturing fared less well, contracting for the third consecutive quarter. The largest decline was in basic metals, highlighting that UK steel makers are struggling amid an oversupply flowing from weaker global demand. Also, mechanical equipment declined sharply, thanks to the lingering drag from the collapse in crude oil prices on investment in the North Sea. We expect the economy to grow 2.4% this year, revised down by one-tenth of a percentage point from last quarter's forecast. The economy is forecast to expand 2.1% in 2016, revised seven-tenths of a percentage point lower than our previous forecast.

UK HEADLINES

- Economic growth is set to ease to 2.4% this year and 2.1% in 2016
- Slower jobs growth and welfare cuts to weigh on private consumption
- Weaker demand from emerging markets to drag on exports
- Official interest rates to start rising during the first half of 2016

DOMESTIC ECONOMY COMING OFF THE BOIL

The second estimate of UK GDP in the third quarter saw a strong rise in fixed investment. Manufacturing remained in recession, falling 0.3% after dropping 0.5% in the second quarter and declining 0.1% in the three months to March.

Strong real wage growth and high employment have supported consumer spending. Real wage growth has benefited from inflation hovering around zero since early this year and wage growth trending upward since late 2014. Also, the employment rate – the proportion of people aged from 16 to 64 who have a job – remains at a record high.

Looking ahead, private consumption is set to moderate but remain the main growth driver. Consumer spending

is likely to come under pressure from slower jobs growth and rising inflation. Employment growth has been on a weakening trend since early this year following very strong gains. Inflation is likely to rise, reducing households' purchasing power, as the downward pressure from the fall in oil prices in late 2014 passes out of the annual rate.

The Bank of England (BoE) expects inflation to rise to 2%, its target, by late 2017. Yet consumer spending should get some support from the introduction of the national living wage for low-paid workers aged over 25 early next year, which will be higher than the current minimum wage. Also, oil prices are likely to remain relatively low, keeping a lid on petrol and diesel prices.

The BoE will probably start raising interest rates during the first half of 2016. The risks to the UK outlook are weighted to the downside, with the main threat a collapse in China triggering a major global downturn.

UK ECONOMIC FORECASTS

% CHANGE EXCEPT WHERE STATED

	2013	2014	2015	2016
Trading environment				
Exchange rate (€/£)	1.18	1.24	1.38	1.37
Exchange rate (\$/£)	1.56	1.65	1.53	1.46
Exports	1.2	1.8	2.4	1.8
Imports	2.8	2.8	2.9	3.5
Current account (% GDP)	-4.5	-5.1	-4.7	-5.0
Output				
Manufacturing	-1.1	2.7	-0.1	0.8
GDP	2.2	2.9	2.4	2.1
Costs and prices				
Average earnings	1.2	1.4	2.7	3.4
Oil price (Brent Oil \$/bl)	108.6	99.0	53.9	52.8
Employment				
Manufacturing (000s)	2,557	2,592	2,612	2,579
Rest of economy (000s)	29,712	30,751	31,109	31,300
Unemployment rate (%)	7.6	6.2	5.4	5.4

Source: Oxford Economics and EEF

GLOBAL ECONOMIC OUTLOOK WEAKER

- Global growth outlook deteriorates
- US Fed likely to start raising interest rates in December
- Corporate defaults in emerging markets are a key risk

Global growth has eased this year, led lower by China, but is likely to pick up in 2016. The world economy is forecast to expand 3% in 2015, revised down one-tenth of percentage point from last quarter’s forecast. Global growth is expected to accelerate to 3.5% in 2016, revised two-tenths of a percentage point lower than our previous forecast.

In China, official real GDP growth is likely to slow to 6.9% this year and 6.3% in 2016. Policymakers are struggling to rebalance the growth drivers away from fixed investment toward private consumption. Consumer spending is under pressure from recent weakness of housing and stock markets dragging on households’ perceived wealth. The central bank has eased monetary policy to support the economy and is likely to do so again. Exports are set to weaken on softer demand from other emerging markets.

The recent weakness of commodity prices has hit emerging economies that rely heavily on exports of oil and iron ore, such as Russia and Brazil respectively, hard. Also, companies in emerging markets that borrowed cheap funds flowing from the Fed’s quantitative easing are struggling to repay their debts as the subsequent end of the program has pushed up borrowing costs.

US economic growth is forecast to be steady at 2.4% this year and pick up to 2.7% in 2016. Domestic demand is set to strengthen as the improving labour market lifts private consumption, and the resulting wider profit margins encourages business investment. Yet exports are likely to be under pressure from weaker demand from emerging economies and the US dollar remaining strong. The Fed is widely expected to start increasing the Funds rate in December.

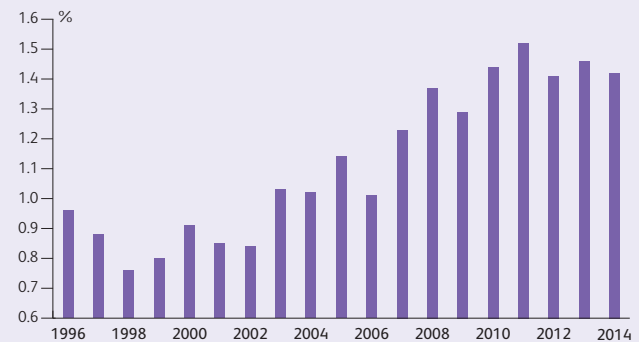
In the eurozone, economic growth should pick up to 1.4% this year and 1.8% in 2016. Consumer spending is likely to benefit somewhat from steady job growth. Also, government spending will help as some members ease fiscal policy slightly. Inflation is forecast to rise but remain well below the ECB’s target of 2% for a prolonged period.

INDIA SPOTLIGHT

India’s economy grew 7% in year-ago terms in the three months to June, outperforming other emerging markets. The UK is unlikely to benefit from India’s recent strong real GDP growth much because it is not a major trading partner. India’s share of the UK’s total goods trade was only 1.4% in 2014 and has been on a downward trend since 2012. The UK’s top exports to India are non-ferrous metals, non-metallic mineral manufactures, and power generating machinery and equipment. The main UK imports from India are machines and engines and pumps, crude oil, and clothing. India was the third largest source of foreign direct investment for the UK in terms of number of projects in 2014-15, according to UKTI. In the event of a China collapse, India’s economy is better positioned than other emerging markets because it is largely relies on domestic demand, particularly private consumption, to drive growth.

INDIA’S SHARE OF TOTAL UK TRADE

TRADE WITH INDIA, % OF UK TOTAL



Source: UKtradeinfo

ECONOMIC ENVIRONMENT

The ECB is concerned about the risks associated with inflation being too low for too long and has signalled it will extend its quantitative easing program in December if necessary.

Japan's economy is expected to expand 0.6% this year and 1.5% in 2016. Private consumption is likely to recover gradually as the labour market improves. Also, healthy corporate profits should support a modest expansion in business investment. Exports will probably weaken on softer demand from emerging markets. The likelihood of

the central bank easing monetary policy further recently increased after the economy went back in recession in the third quarter.

The risks to the global outlook are also skewed to the downside, with the key threat a collapse in China. Another major risk is that the higher borrowing costs flowing from the Fed starting to raise interest rates triggers a wave of corporate defaults in emerging markets.

SECTOR FORECASTS

The environment for manufacturing has gradually deteriorated over the course of 2015. While the poor start to the year was concentrated on a smaller number of sectors, this weakness has broadened considerably as we approach 2016. Some of the headwinds have been a consistent theme over 2015 – the collapse in oil & gas activity, weakness in key export markets and strong sterling. Others, like disappointing construction activity and the breakdown in the steel industry have piled on the pain since q2 2015. It's not all doom and gloom however, with the resilience of the transport sectors and the rejuvenation of the pharmaceuticals industry providing reasons for cheer in UK manufacturing.

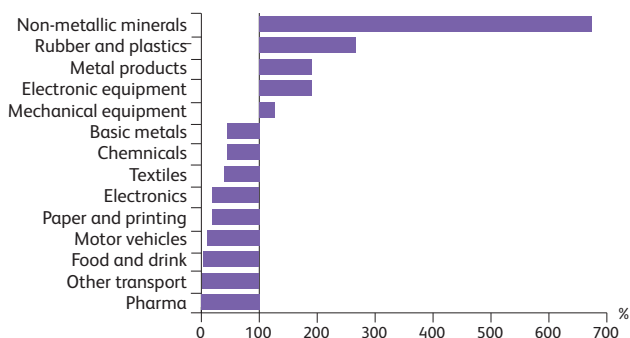
OIL & GAS SUPPLY CHAIN REMAINS UNDER PRESSURE

Sectors embedded in the oil & gas supply chain continue to struggle. The **mechanical equipment** sector is bearing the brunt of the drying up of capital expenditure from the North Sea, further aggravated by a generalised slowdown in global manufacturing. As a result, the sector is expected to contract by a hefty 13.1% this year.

Prospects look better for next year, where we expect the sector to bottom out in q1 2016 and grow thereafter, driven by a recovery in UK manufacturing and oil and gas companies readjusting their business models to lower long-term oil prices. Still, base effects from 2015 should mean a contraction of 2.0% for the year as a whole.

SECTORS EXPOSED TO CONSTRUCTION HAVE SEEN SUBDUED DEMAND IN H2 2015

INDEX, MANUFACTURING AVERAGE = 100)



Source: ONS

FOOD & DRINK FAILS TO PIGGYBACK ON STRONG CONSUMER

The **food and drink** industry, which chiefly caters to the domestic market, has seen output contract over the first half of the year. However, this is down to the ongoing supermarket price wars – putting pressures on margins, and eventually on output – rather than a reflection of weak demand.

Price pressures have relaxed over H2 2015 and in conjunction with a positive boost from the Rugby World Cup, we expect output to grow slightly in q4 after expanding in q3, taking the sector to flat growth in 2015. Prospects are brighter for next year, with evidence that

food and drink manufacturers are rationalising their supply chains as well as expectations for continued strong household consumption aligning to drive growth of around 1.1%.

NO SUPPORT FROM BRICKS AND MORTAR

Construction activity has surprised on the downside, with the drop in output in q3 more than wiping out any gains made in the first two quarters of the year. For manufacturing sectors in the construction supply-chain, like non-metallic minerals and rubber and plastics, this has spelled bad news.

The **non-metallic minerals** sector is the most exposed, with 60% of intermediate demand absorbed by the construction industry. The sector saw output drop by 3.3% in q3, and expectations of flat growth in q4 should mean the sector contracts by 0.5% over 2015. A rebound in construction next year should give the sector a boost, however unfavourable base effects from 2015 could mean flat growth for 2016.

The **rubber and plastics** sector is also significantly exposed to the construction sector but benefits from a more diverse demand base, with a good chunk of output supplied to the buoyant motor vehicles sector. Nevertheless, a very poor start to the year means that despite expecting growth over the second half of 2015, output is likely to contract by 2.6%. Nevertheless, innovation activity and growth in demand for packaging, comprising almost a fifth of sector output, is expected to drive robust growth in 2016.

HEADWINDS PILE ON FOR THE METALS INDUSTRY

The recent closure of a number of iron and steel plants has grabbed media headlines over the past quarter. This has been well reflected in official data, with the **basic metals** sector contracting by 5% and 11% in q2 and q3 respectively. Chinese steel dumping has aggravated existing competitiveness issues in the basic metals sector, which has been suffering from an uncompetitive exchange rate and a slowdown in global demand. Next year is unlikely to be much different, where we expect output to fall by 12.6% after contracting by 9.5% in 2015.

The **metal products** sector is more diverse in its demand base and less export-intensive than basic metals. This means that the sector is better protected from the contraction in domestic industry and the slump in global trade. We expect the sector to expand by a solid 2.8% this year, driven by growth in the motor vehicles and other transport sectors, which account for about a fifth of the sector's intermediate demand. Next year the pace of growth is expected to slacken to 0.5%, albeit with upside risks attached to this forecast.

PHARMACEUTICALS STAGE A COMEBACK

The **pharmaceuticals** industry is seeing a rejuvenation of late. After five consecutive years of contraction, the sector is finally coming off the patent cliff. Fundamentals are now looking strong for the industry, with ongoing acquisitions and pipelines for new products coming on stream. We expect the sector to grow by 1.0% this year and we see upside risks to our forecast for robust growth of 2.2% in 2016.

The **chemicals** sector, although related to the pharmaceuticals industry, is affected by different dynamics. The sector looks set for solid growth in 2015, with deflation in input prices from the low oil price helping to prop up output. The sector has seen positive growth in overseas sales in 2015 with the US, China and Middle East absorbing the lion's share of chemicals exports. Growth is expected for 2016 too, albeit at a slower pace as the boost from low oil prices dissipates.

SECTOR FORECASTS

TRANSPORT SECTORS DRIVE ON

The transport sectors continue to have a momentum of their own. **Motor vehicles** remain on their strong growth trajectory, capitalising on the introduction of new models and strong consumer demand. The sector also looks to have shrugged off the slump in demand from China, where exports have dropped by 22% compared to last year, with strong growth in exports to the US and non-traditional markets in Latin America and the Middle East.

The **other transport** sector has returned to growth with a shout and we expect rapid growth of 6.7% in 2015. Companies in the aerospace industry are reporting large backlogs and record production rates swelling up their revenues. Fast growing demand for aircrafts in Asia Pacific is contributing to this buoyant outlook. Solid growth is expected to carry over to 2016, where we forecast a 5.1% expansion.

SECTOR GROWTH RATES AND FORECASTS

% CHANGE

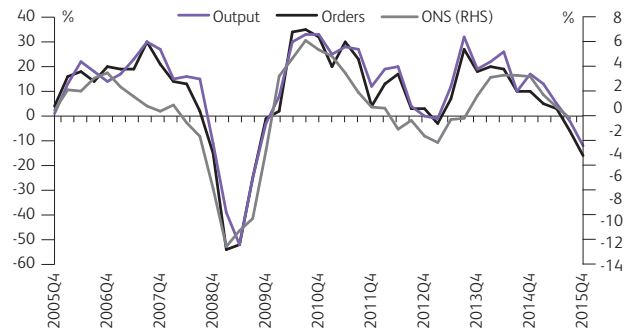
	OUTPUT			EMPLOYMENT		
	2014	2015	2016	2014	2015	2016
Basic metals	-1.0	-9.5	-12.6	2.8	-5.0	-9.6
Metal products	3.0	2.8	0.5	-0.6	-3.3	-0.1
Mechanical	4.6	-13.1	-2.0	1.3	-2.0	0.2
Electronics	4.0	-1.5	2.5	2.1	2.0	-1.9
Electrical	-3.0	-1.0	-0.3	-6.2	3.2	-1.3
Motor vehicles	8.2	5.0	2.7	-0.9	4.5	2.0
Other transport	-2.5	6.7	5.1	3.2	1.0	0.5
Food and drink	4.6	0.1	1.1	3.4	1.0	-2.8
Chemicals	2.7	5.9	1.2	12.8	-0.2	-3.8
Pharmaceuticals	-5.1	1.0	2.2	3.6	-3.1	1.5
Rubber and plastics	12.3	-2.6	2.6	5.8	5.7	1.5
Non-metallic minerals	14.6	-0.5	-0.1	-1.3	3.5	0.0
Paper and printing	-0.7	-0.7	0.3	8.2	-5.6	-1.9
Textiles	-3.5	-2.2	-2.3	-3.1	-1.1	-9.9
Manufacturing	2.7	-0.1	0.8	1.6	0.8	-1.3

Source: EEF and Oxford Economics

HISTORIC MANUFACTURING TRENDS

OUTPUT GROWTH CONTINUES TO TAIL OFF AS ORDERS DRY UP

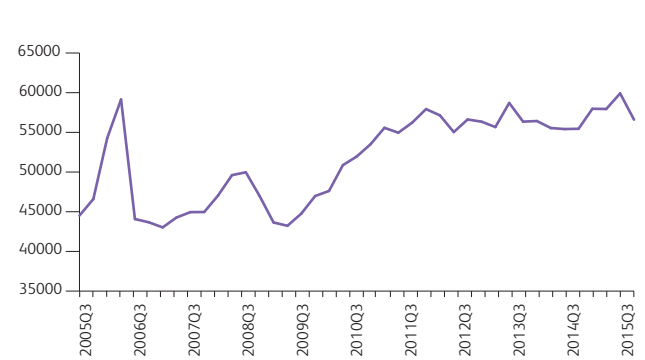
% BALANCE OF CHANGE IN THE PAST THREE MONTHS AND % CHANGE ON A YEAR AGO



Source: EEF Business Trends Survey and ONS

EXPORTS RETREAT AFTER LONG START TO THE YEAR

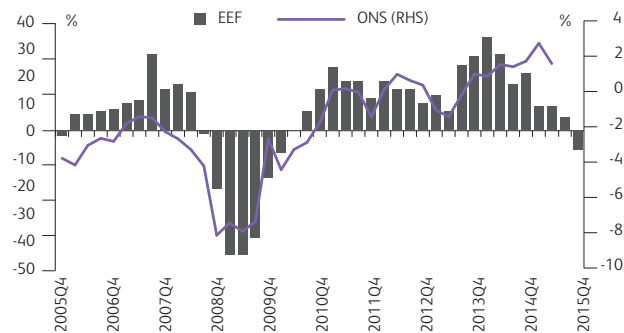
MANUFACTURED EXPORTS, VALUE (£M)



Source: EEF Business Trends Survey and ONS

RECRUITMENT TURNS NEGATIVE FOR THE FIRST TIME IN OVER FIVE YEARS

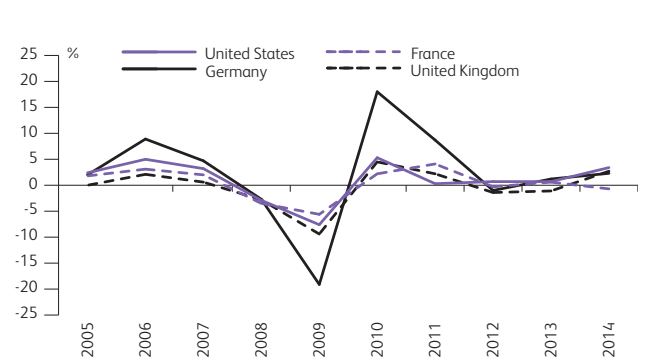
% BALANCE OF CHANGE IN THE PAST THREE MONTHS AND % CHANGE ON A YEAR AGO



Source: EEF Business Trends Survey and ONS

UK MANUFACTURING CATCHES UP IN 2014

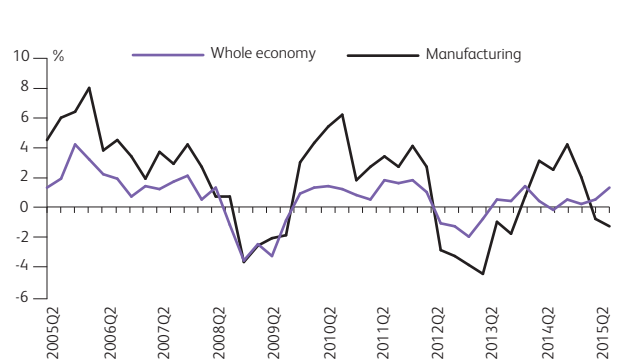
MANUFACTURING GVA, ANNUAL % CHANGE



Source: OECD

WHOLE ECONOMY PRODUCTIVITY RACKS UP A YEAR OF GROWTH

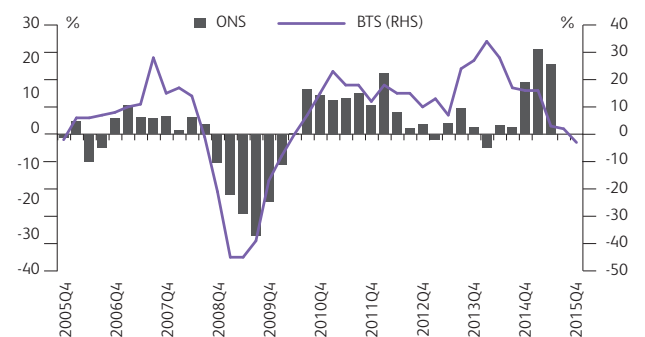
OUTPUT PER HOUR, ANNUAL % CHANGE



Source: ONS

MANUFACTURERS TO SCALE BACK INVESTMENT AFTER 5 YEARS OF GROWTH

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



Source: EEF Business Trends Survey and ONS

THE EU-CANADA ECONOMIC TRADE AGREEMENT – WHAT YOU NEED TO KNOW

CETA will open up a number of opportunities for UK manufacturing companies in Canada, placing UK companies on a level, if not advantageous, playing field compared to other countries – for example, the US.

UK Trade and Investment have estimated that CETA will boost the UK economy by £1.3 billion per year.

WHAT IS CETA?

The Comprehensive Economic and Trade Agreement (“CETA”) is a trade and investment agreement that has been negotiated between the European Union (the “EU”) and Canada. CETA aims to improve trade and investment between the EU and Canada through the removal of customs duties, increasing access to public contracts, opening up services’ market, offering more predictable conditions for investors and protecting EU innovations and traditional products.

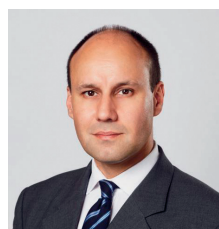
BENEFITS OF CETA FOR UK MANUFACTURERS

- **Cutting the cost of exporting and importing goods between the EU and Canada.** CETA will eliminate all industrial duties, estimated to save European exporters around €470 million a year. Most industrial customs duties will be removed when CETA enters into force and some will be gradually eliminated, with the phase outs ranging from 3-7 years depending on the product. For instance, Canadian customs duties payable on the import of a number of EU origin plastic products will be removed immediately, whereas duties payable on certain EU origin automobiles will be phased out over eight years.
- **Protecting EU innovation.** CETA will create more of a level playing field between Canada and the EU as regards to intellectual property rights, providing better protection for European innovations and brands.
- **Promoting and protecting investment in Canada.** CETA removes and alleviates barriers for European investors to enter the Canadian market and ensures equal treatment.

- **Increasing access to public contracts.** CETA will allow EU companies to bid for public contracts in Canada on a federal, provincial and local level and ensures EU companies are not discriminated against in the bidding process.
- **Increasing regulatory co-operation.** CETA contains provisions that will improve transparency and form closer contacts in the field of technical regulation, such as in the area of motor vehicle technical regulations/related standards, between the EU and Canada.
- **Increasing trade in services.** CETA is providing new opportunities for EU service providers and will increase opportunities for temporary movement of employees between the EU and Canada.
- **Tightening up the existing ‘investment-to-state arbitration’ provisions.** Such provisions allow foreign investors to bring proceedings directly against a state via a separate arbitral process, rather than using the domestic legal system. CETA has introduced provisions to supplement the current investment arbitration system, such as increasing transparency by making decisions and hearings publicly available.

WHEN WILL CETA ENTER INTO FORCE?

The CETA negotiations concluded in August 2014. However, CETA must be approved by the European Parliament and EU Member State governments before it can come into force. It is estimated that CETA could be applied from early 2017, provided that the Council, European Parliament and the Canadian legislature approve CETA in 2016 as expected.



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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.

ABOUT DLA PIPER

DLA Piper is a global law firm with lawyers located in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East, positioning it to help companies with their legal needs anywhere in the world.

At DLA Piper we take our expertise in and commitment to the manufacturing sector very seriously. We have built a strong reputation for supporting organisations engaged in all aspects of manufacturing. We are committed to understanding the markets our clients operate in and the specific commercial challenges you face. Our international team of lawyers has considerable experience of working with a broad range of blue chip manufacturing businesses, both in the UK and internationally. Supporting our manufacturing clients with issues across all aspects of business from products, operations, customers, people, finance and risk, governance and compliance.

For further information about our organisation and services, please visit our website: www.dlapiper.com

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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

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