Manufacturing a recovery

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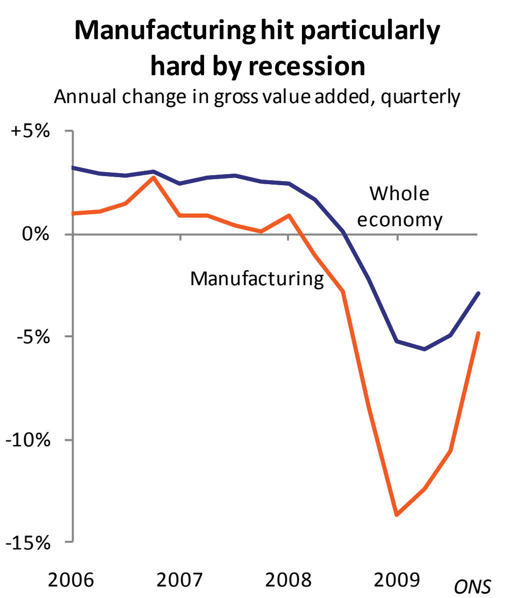
A weak pound offers hope for manufacturing, but it does not guarantee success

The UK manufacturing sector has suffered long-term decline. It accounts for around 12% of national output, half its share 30 years ago. This trend is reflected in all major developed economies, with the notable exception of Germany, as production has moved to low cost producers in developing countries. Manufacturing also underperformed the rest of the economy during the recent recession: early predictions of a "white collar recession" were not realised.

However, manufacturing remains important - it accounts for 2.6 million, one in ten, jobs – and the outlook for the sector is not entirely bleak. Growth in manufacturing is expected to exceed that in services in 2010, 2011 and 2012. Optimism for the sector has focussed on the potential economic dynamism and balance offered by modern manufacturing, together with the export opportunities associated with the weak pound.

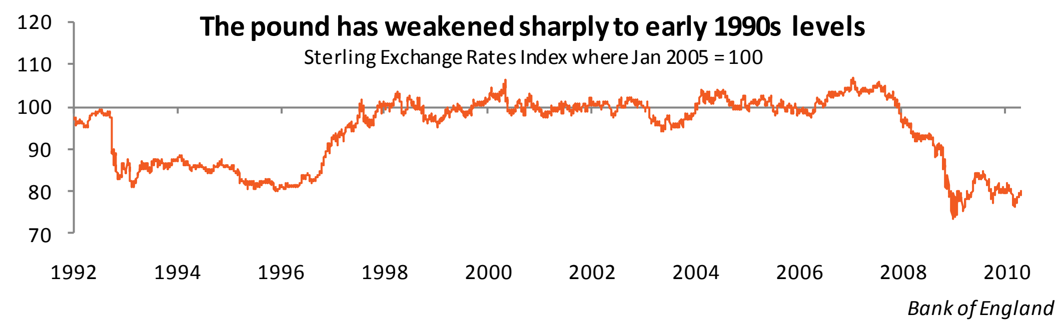


A MODERN MANUFACTURING SECTOR

Lord Mandelson's tenure as Business Secretary was characterised by a renewed focus on investment in high-value-added "advanced manufacturing". The Conservatives have adopted a similar tone, promising to provide policy leadership and infrastructure to promote high-tech industry.

Arguments for promoting advanced manufacturing are varied. These include:

- The creation of a more balanced UK economy less dependent on financial services
- Britain is already relatively successful in some areas of advanced manufacturing, such as aerospace and pharmaceuticals
- Opportunities for growth and skilled employment through leadership in expanding sectors such as low-carbon technology, where the UK can establish a comparative advantage
- The use of developing technology and techniques means that advanced manufacturing may offer greater potential for productivity growth than some other sectors, such as customer services
- The tangible and symbolic importance of manufacturing, which is often concentrated in relatively deprived areas
- Manufacturing is a key export sector: UK manufacturing exports were almost £180 billion in 2009, 46% of the total



AN EXPORT-LED RECOVERY?

Against a trade-weighted basket of currencies, the pound weakened by 27% between early 2007 and early 2009. It remains at levels not seen since the early 1990s, after the UK left the Exchange Rate Mechanism. A weaker pound makes UK exports cheaper and, all other things being equal, would be expected to increase overseas demand for UK goods. A "golden age for exporters" has been widely heralded.

In practice, the relationship between the exchange rate and manufacturing performance is complicated by a wide variety of factors. These include:

- International demand: there is little benefit in having competitively priced products unless someone wants to buy them and economic growth is sluggish in some of the UK's biggest export markets. More than half of the UK's goods exports are to other EU countries
- Domestic demand: economic growth has also been slow at home, though a weak pound may help UK producers regain domestic market share from imports
- Firms may choose to increase profit margins on existing volumes rather than increase output and employment

Could the Government do more to help? A recent Business Select Committee report suggested that UK Trade and Investment, the Government organisation responsible for trade promotion, could be more active in alerting companies to potential opportunities. The recession also severely constrained the availability of trade credit, making it more risky for firms to export. Exporters have urged the UK Government to follow the lead of some European competitors in providing short-term export credit guarantees.

Evidence so far of a boom in manufacturing exports is patchy at best. However, there does tend to be a lag between currency devaluation and increases in export market shares. The coming months will tell us much about the future of manufacturing in the UK and its ability to fuel wider economic recovery.