

UK manufacturing report

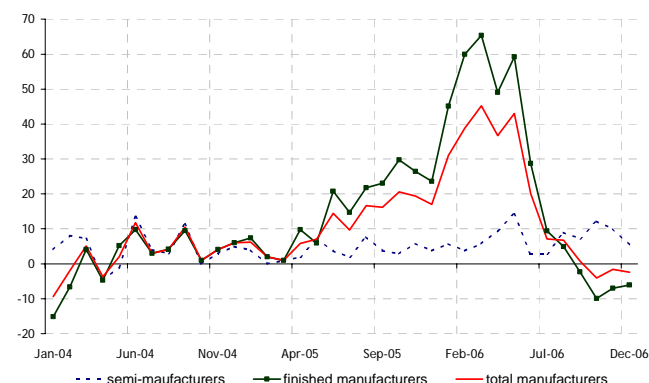
Executive summary

After faltering in late 2006, manufacturing has regained momentum in early 2007. We are forecasting moderate growth in manufacturing in 2007.

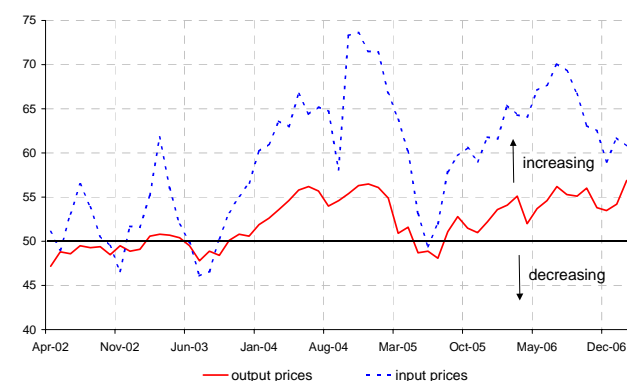
Key trends

- Quarterly growth in manufacturing slips to only 0.1% in the December 2006 quarter.** After expanding at a solid pace during the first nine months of 2006, growth in manufacturing output slipped sharply in the final three months of the year.
- Exports of manufactured goods turn down in late 2006.** Annual growth in the export of finished manufactured goods turned towards the end of last year, underpinning a small decline in the annual growth of total manufactured exports late last year.
- Survey data points to a resumption of modest growth in manufacturing output in early 2007.** Both the purchasing managers' index and the CBI industrial trends survey indicate that manufacturing activity has strengthened in early 2007. Survey respondents also report that confidence in export markets is holding up well, despite the strength of Sterling.
- Price pressures building.** After a sustained period of higher input prices, manufacturers are now seeking to rebuild their margins by raising their output prices. The PMI survey reported that the prices charged index is now at its highest level since the series began.

Exports of manufactured goods (percentage change, year on year)



CIPS/RBS PMI survey of manufacturing, input and output prices (50 = no change on previous month)



Recovery in manufacturing falters in final quarter of 2006

After recording three consecutive quarters of robust growth, quarterly growth in manufacturing output slowed sharply to only 0.1% during the December 2006 quarter. That said, annual growth in manufacturing output was still up by 2.6% on year earlier levels in December 2006.

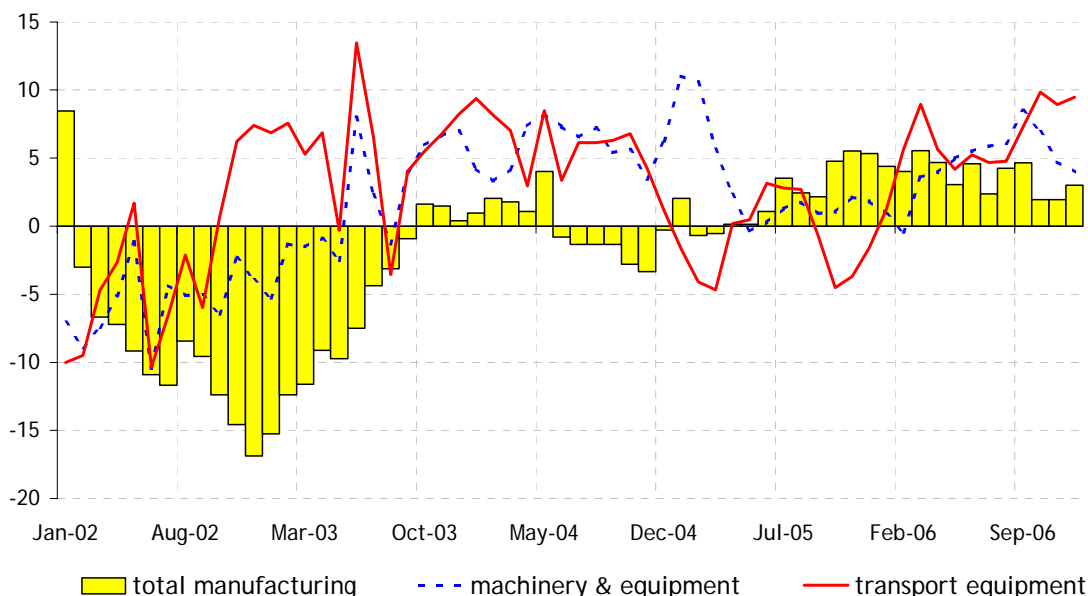
The pick-up in manufacturing output during 2006 was underpinned by the manufacture of capital and consumer durable goods. The stronger performing manufacturing sub-sectors during the year were transport equipment and machinery. Moderate growth was also recorded in basic metals & metal products, chemicals & man-made fibres, and rubber & plastic products. The weakest performing sub-sector was textiles, leather & clothing, which recorded a drop in output during 2006.

Lackluster growth in manufacturing during the final quarter of 2006 partly reflected trends in the export of manufactured goods. Exports of manufactured goods grew very strongly during the first half of 2006, underpinned by rapid growth in the export of finished manufactured goods. A steep decline in the export of capital goods underpinned a downturn in the export of finished manufactured goods during the second half of 2006. By December 2006, the export of all manufactured goods was down by 2.4% on year earlier levels.

Momentum regained in early 2007

Survey data suggests that manufacturing has regained momentum in early 2007. The Bank of England Agents' summary of business conditions reported that output growth remained robust, despite an easing in export growth. Growth in domestic demand remained unchanged. Manufacturers reported that the

Manufacturing output (percentage change, year on year)



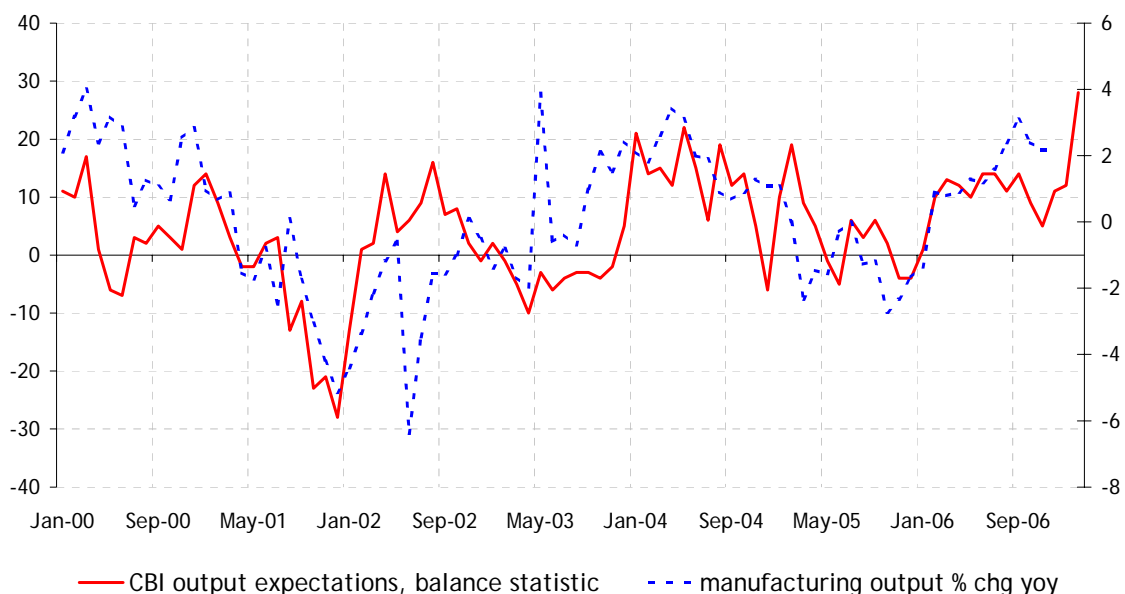
strengthening of Sterling was hurting their competitiveness and market share. Investment remained subdued and was predominantly focused on improvements in efficiency. Nevertheless, manufacturers remained optimistic about their future, reflecting a robust outlook for global demand, and this was reflected in a small increase in pre-tax profitability. While manufacturers reported that their annual rate of output price inflation edged lower in January, they also reported that they planned to rebuild margins during the year.

The purchasing managers' index for manufacturing pointed to a marked strengthening in manufacturing activity in early 2007, with output climbing to a five month high in February. A strong rise in the new orders index to a two-and-a-half year high and a pick-up in export demand (despite the strength of Sterling) suggested that activity will remain buoyant over coming months. Manufacturers also reported that they increased their staffing levels, in contrast to the

overall decline in manufacturing employment seen during last year. The prices charged index, however, increased to its highest level in February since the series began as manufacturers sought to rebuild their margins. The input prices index, while down from the highs recorded during 2006, remained at an elevated level.

The CBI's Industrial Trends Survey also points to an upbeat outlook for manufacturing in early 2007. A net balance of +4% of respondents said that their order books were above normal, leading to the strongest growth expectations in 12 years. Thus survey respondents expected output to increase over the next 3 months, with the capital and intermediate goods sectors the most upbeat. Higher confidence was underpinned by stronger domestic demand, particularly in the consumer sector. Confidence in the export facing sectors was also holding up well, despite the rising in Sterling.

CBI Industrial Trends Survey and Manufacturing Output



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