

Quarterly Review

JUNE 2008

DESPITE PRICE RISES, MARGINS REMAIN TIGHT FOR ENGINEERING MANUFACTURING

- Electronics sector maintains strong order intake
- Order Intake continues to be positive
- Margins remain tight
- Fabricators and metal manufacturers are under pressure
- Capital Investment and Training plans still positive

Scottish Engineering's Annual Awards Dinner celebrated another year of significant success in the manufacturing engineering sector. Our guest of honour, Scotland's First Minister the Rt Hon Alex Salmond MSP was justifiably impressed by the range, diversity and overall success of the various award winners.

Entrepreneur Jim McColl in receiving the top award for 2008 gave a very upbeat response for the sector, specifically highlighting the wide range of opportunities for global growth.

During my introduction I invited the First Minister to lend his support to the sector by ensuring that engineering is included in our schools' curriculum alongside science, technology and maths.

Meanwhile our member companies are struggling to contain their costs particularly bearing in mind the dramatic increase in energy prices. While this is resulting in companies winning price increases it is doing nothing to increase overall margins.

Commentators and economic forecasters are currently predicting that the next 12 months will prove difficult for the UK economy albeit they believe we will avoid slipping into recession.

The significant improvements our sector has achieved in recent years with the introduction of a variety of lean initiatives will certainly help us during these difficult times.

Dr PETER HUGHES, OBE FREng
Chief Executive
Scottish Engineering



ANNUAL TRENDS

The Scottish manufacturing engineering sector has seen order intake figures remain positive for 19 consecutive quarters.

Output volume returns have moved back into positive after a zero return last quarter which followed 17 consecutive positive quarters.

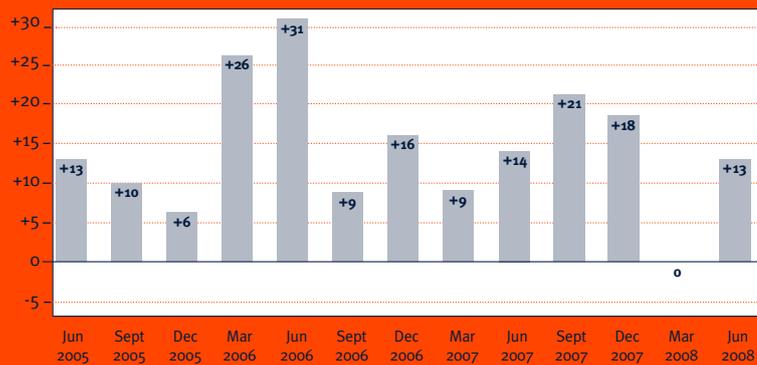
Capacity utilisation marches on to its 15th consecutive positive quarter. Both training and capital investment plans remain positive, as they have now been for 17 consecutive quarters.

Optimism remains positive for the 12th consecutive quarter.

ORDER INTAKE



OUTPUT VOLUME



EXPORTS

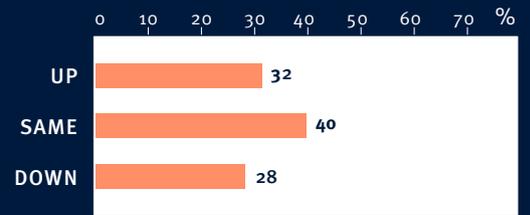


STAFFING

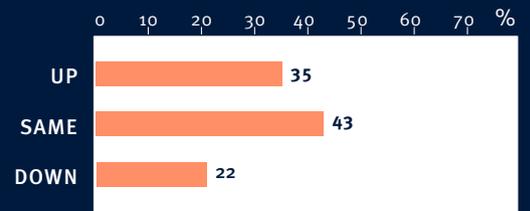


Balance between reports of increases and reports of decreases

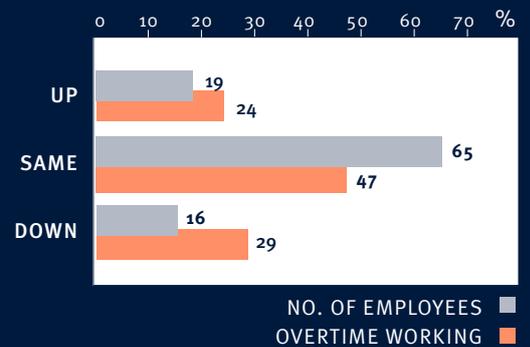
ORDER INTAKE



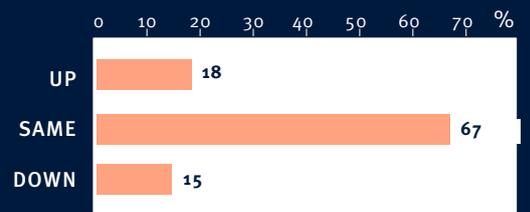
OUTPUT VOLUME



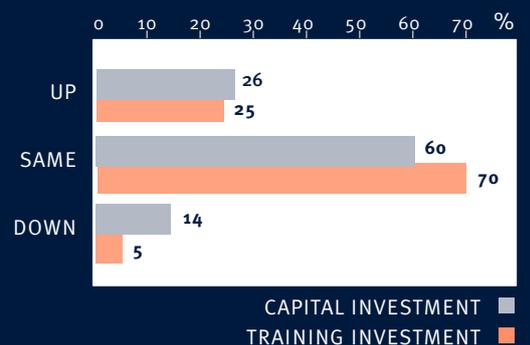
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OPTIMISM



INVESTMENT



ORDER INTAKE

Orders remain positive in medium and large companies but small companies are now negative.

OUTPUT VOLUME

All sizes of company are positive but metal manufacturers and fabricators are reporting a downturn.

STAFFING

Overall staffing levels are up but they are down in small companies and static in large companies. Electronics has significantly improved employee intake while electrical goods and metal manufacturing have fallen heavily.

OPTIMISM

In general, optimism is positive but the exceptions are electrical goods, fabricators, machine shops and non-metal products.

INVESTMENT

The overall situation is positive with only fabricators negative in capital investment plans and non-metal products negative in training plans.

The overall order levels for the engineering industry remain positive for another quarter while particular sectors are reporting poorer results. In particular fabricators and metal manufacturers are seeing substantially more companies reporting that their orders have dropped than those reporting increases.

For the third consecutive quarter the electronics sector has maintained a high level of order intake, but this quarter they have reported price increases in both UK and export orders - and even more important positive margins.

Orders

The general total order intake (32%up,40%same,28%down) ensures that the manufacturing engineering sector remains positive for its 19th consecutive quarter. This trend is confirmed in medium (36%up,41%same,23%down) and large companies (56%up,44%same,0%down) but not in small companies (28%up,39%same,33%down).

UK orders in general (23%up,49%same,28%down) are negative as they are in small (26%up,42%same,32%down) and medium companies (15%up,62%same,23%down) while large companies (30%up,60%same,10%down) maintain their positive position.

Within the various sectors, electronics (46%up,39%same,15%down) keep a high profile but mechanical equipment (16%up,52%same,32%down), fabricators (18%up,37%same,45%down) and metal manufacturing (25%up,42%same,33%down) present negative returns.

Forecasts for UK orders in the next three months in general (22%up,66%same,12%down) remain positive and this is mirrored in small (20%up,68%same,12%down), medium (22%up,70%same,8%down) and large companies (40%up,40%same,20%down).

Export orders overall (25%up,47%same,28%down) for the last three months have returned to a negative position but only small companies (16%up,49%same,35%down) reflect this trend. Both medium (33%up,42%same,25%down) and large companies (50%up,50%same,0%down) are positive.

In this market, electronics (45%up,37%same,18%down), oil and gas (40%up,60%same,0%down) and transport (57%up,14%same,29%down) show positive figures while non-metal products (17%up,33%same,50%down) and mechanical equipment (18%up,43%same,39%down) present negative returns.

Predictions for the next three months generally (29%up,60%same,11%down) are very positive, as are small (24%up,62%same,14%down), medium (37%up,54%same,9%down) and large companies (25%up,75%same,0%down).

Prices and margins

UK prices have risen in small (38%up,61%same,1%down), medium (29%up,60%same,11%down) and large companies (10%up,70%same,20%down) over the last three months. Prices have also risen in all sectors except electrical goods (0%up,75%same,25%down). Mechanical equipment (28%up,70%same,2%down) and fabricators (42%up,58%same,0%down) have shown considerable positive movement.

In the next three months predictions for UK prices are positive in general (30%up,64%same,6%down) which is the same in small (32%up,64%same,4%down) and medium companies (36%up,58%same,6%down) but not in large companies (0%up,80%same,20%down).

Export prices for the past three months in general (27%up,64%same,9%down) have been positive as have small (24%up,68%same,8%down) and medium companies (31%up,63%same,6%down). Large companies (25%up,50%same,25%down) have an equal number of companies increasing prices as those decreasing. In the various sectors, electronics (30%up,50%same,20%down), mechanical equipment (30%up,64%same,6%down) and metal manufacturing (44%up,56%same,0%down) have recorded positive results.

The forecast for the next three months of export prices in general (23%up,68%same,9%down) continue positive as they are in small (13%up,80%same,7%down) and medium companies (35%up,56%same,9%down) while large companies (25%up,50%same,25%down) have a similar number of companies predicting increases as are predicting falls.

In all sizes of company and sectors, only the electronics sector (17%up,75%same,8%down) has a positive figure for UK sales margins. In general terms (8%up,66%same,26%down) the results were also negative. The forecast for the next three months generally (11%up,71%same,18%down) is still negative.

Export sales margins follow the same path with electronics (25%up,67%same,8%down) being the only sector with a positive message. The general (9%up,71%same,20%down) picture is negative. Looking ahead three months, the general (13%up,71%same,16%down) forecast is negative as are small (8%up,77%same,15%down), and medium companies (17%up,63%same,20%down) though large companies (29%up,71%same,0%down) are more optimistic.

Optimism

The level of optimism (18%up,67%same,15%down) in general terms remains positive as it is in electronics (46%up,54%same,0%down) and metal manufacturing (23%up,77%same,0%down) but not in mechanical equipment (12%up,73%same,15%down) or fabricators (8%up,67%same,25%down).

Investment

Both capital (26%up,60%same,14%down) and training (25%up,70%same,5%down) investment plans remain positive.

Training plans in small (22%up,73%same,5%down), medium (28%up,64%same,8%down) and large companies (30%up,70%same,0%down) are all positive.

Similarly capital investment plans are positive for small (22%up,62%same,16%down), medium (32%up,58%same,10%down) and large companies (30%up,60%same,10%down).

Staffing

Levels of staffing in general (19%up,65%same,16%down) for the last three months were positive as were medium companies (28%up,57%same,15%down) but not small companies (13%up,73%same,14%down). Large companies (30%up,40%same,30%down) were equally split between those taking on staff and those losing staff. The electronics sector (23%up,77%same,0%down) and mechanical equipment (22%up,66%same,12%down) were positive but non-metal products (12%up,38%same,50%down) saw a substantial negative result.

Forecasts for the next three months in general (22%up,68%same,10%down) remain positive as they are in small (17%up,73%same,10%down), medium (29%up,58%same,13%down) and large companies (30%up,70%same,0%down).

Output volumes

Output volumes have resumed their positive position in general terms (35%up,43%same,22%down) and this has been the situation in small (31%up,44%same,25%down), medium (38%up,44%same,18%down) and large companies (50%up,40%same,10%down). In the sectors, only fabricators (25%up,42%same,33%down) and metal manufacturing (15%up,54%same,31%down) are negative.

The forecast is excellent in general (54%up,46%same,0%down) terms and continues in small (32%up,52%same,16%down), medium (42%up,50%same,8%down) and large companies (50%up,40%same,10%down).

The facts in this Review were acquired by a survey of Scottish Engineering's members and certain other electronic companies and foundries. The membership covers all sectors of the industry. The response rate was 33.5% of members. Companies are described as: Small (less than 100 employees), Medium (100-500) and Large (over 500).

The Back Page



Tom Vosa,
Chief Economist,
Clydesdale Bank

It seems that we are regularly being told that employment is at record levels, inflation is well under control, interest rates are less than half the level reached under the last Conservative Government and there will be no return to boom and bust.

Many economic commentators are however quick to point out that a large part of the economic growth has been driven by public and private borrowing – government spending and mortgage equity withdrawal – and there has been a shift away from manufacturing industry towards financial services, mostly in the City of London and the towers of Canary Wharf.

And now we have to contend with ‘the credit crunch’. Those three words have caused panic and fear to abound through the UK economy, but is it really as bad as we think? The majority of engineering firms have tried to limit the risk they face by expanding the sectors or the locations in which they operate – and it appears that industry insiders think that only companies within the civil engineering sector are considered to have a real task at hand.

Looking at the economic situation, Scotland currently accounts for around eight per cent of the UK’s output. However surveys suggest a modest bounce in growth in the first quarter leaves Scotland outperforming a slowing UK economy. Surveys also show a sharp slowdown in the rate of expansion as the global credit crunch continues to feed through the broader economy.

In terms of sectoral changes resulting from the credit crunch, new orders have been particularly affected, which suggests that the manufacturing sector will slow further in the three months to June.

With oil over \$125 per barrel – and likely to stay there if futures markets are to be believed – the oil services sector is likely to see continued demand for engineering products. Of course, the rise in sterling against the US dollar means that Scottish

oil-related engineering has probably lost some of its competitiveness at the moment. However, the fall in the pound against the euro provides a partial offset, especially as Scotland trades more intensively with the eurozone than the UK average.

Looking at export price data, it seems that UK exporters are currently pricing to market and increasing their margins by raising sterling prices. While this creates an offset to squeeze margins in the UK, it also creates the risk that net export growth will lag. Given our view that eurozone growth is likely to further contract, the fact that exporters are still raising prices means that export could slow further.

It is likely that we will very probably avoid the textbook definition of a recession. In the UK, this would require either two consecutive quarters of negative growth or a negative rate of year-on-year growth. Even with the stormy clouds from the US, it is hard to make the numbers in our economic models look quite this bad. Indeed much of the discussed UK downturn has been seen in the media not in real economic activity.

The key point to make, though, is that textbooks are not real life. In the real world – which is not necessarily the one described to us by the Chancellor – the rest of 2008 is going to be a very tough six months. What is sure is that when the markets do settle down it will be a very different landscape to that which went before.

Finance Ministers around the world will be quick to tell us that “the fundamentals” are sound. Unfortunately, they won’t be telling us what those fundamentals are.

Whether we look at housing, retail sales, manufacturing production, consumer confidence or business investment, the next 12 months will be very different to the experience of the last few years. It may not be a recession, but it might well feel like one.

