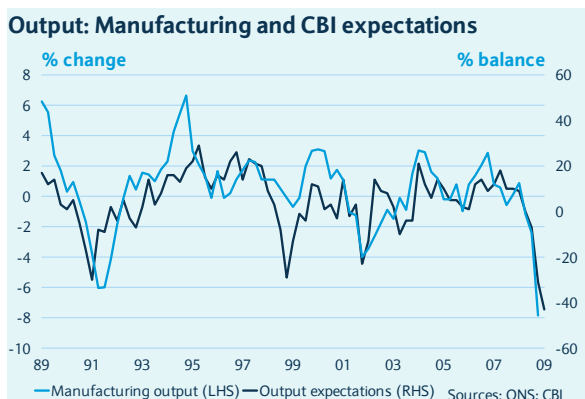


Manufacturing

April 2009

Manufacturing Output

Trading conditions for manufacturers deteriorated rapidly in the second half of 2008; quarterly data from the ONS show that manufacturing output contracted by 4.9% between the third and fourth quarters, and was 7.9% lower than in the same period a year earlier. Output continued to weaken into 2009 and in January was 12.8% lower than a year earlier.



Only two sectors (fuel refining and other transport equipment) recorded positive output growth in the year to the fourth quarter (see chart). In contrast, the production of wood products, building materials, metals and metal products, and motor vehicles all fell by more than 10% over the period.

Manufacturers continue to contend with a contraction in consumer spending and business investment. Mechanical and electrical engineers are suffering from tighter spending on capital goods, motor manufacturers have scaled back production markedly in response to the collapse of new car registrations and those manufacturing building related products have responded to a downturn in construction. This is now having widespread impact on those companies that manufacture materials and intermediate products.

Moreover, widespread destocking at the end of last year exacerbated the impact of depressed final demand, as manufacturers sought to unwind inventories and manage production tightly. A number of business surveys suggest that stock levels remain high and destocking is expected to have continued into 2009, although sufficiently unwinding excess stock is crucial in establishing a position from which production can pick up.

However, high value, highly specialised sectors, such as pharmaceuticals and aerospace, are relatively better placed and will continue to benefit from a strong international reputation and highly specialised technologies, although the latter, in particular, is facing a cyclical downturn in new orders as a result of the difficulties of the airline industry.

Manufacturing output

	Annual % change 2008 / 2007	Annual % change Q3 2008 / Q3 2007	Annual % change Q4 2008 / Q4 2007
Fuel Refining	3.9	0.8	2.3
Chemicals & Pharmaceuticals	0.4	3.0	-4.0
Textiles & Clothing	0.3	-0.2	-1.5
Other Transport Equipment	0.0	5.3	2.7
Mechanical Engineering	-1.2	-2.6	-7.1
Food, Drink & Tobacco	-2.1	-2.1	-3.3
Paper & Board	-2.2	-1.6	-8.4
Aerospace	-2.9	1.0	-2.3
Metal Manufacturing & Metal Products	-4.2	-2.5	-11.6
Electrical Engineering	-4.5	-6.5	-6.7
Building Materials	-4.9	-6.4	-12.0
Plastic Processing	-5.5	-5.8	-9.7
Motor Vehicles	-5.7	-5.7	-25.0
Wood & Wood Products	-6.9	-7.6	-16.2

Source: ONS

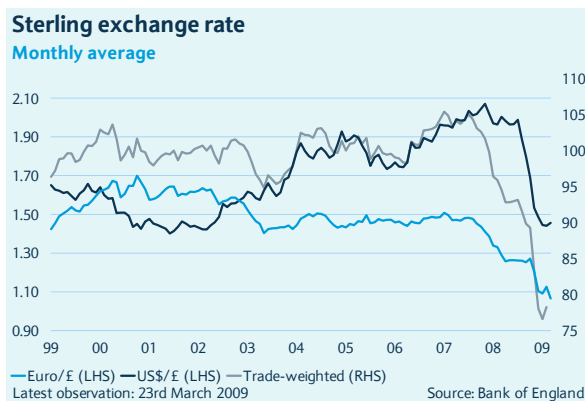
PMI Manufacturing Index

Dec 34.9 Jan 35.8 Feb 34.7

Short term indicators remain very depressed, although the CIPS index has now at least stabilised, having fallen to its lowest level since the survey began in 1992. The index has now been below 50 since May 2008 (a reading of 50 marks the boundary between rising and falling output).



The latest quarterly CBI survey found that the deterioration in overall orders gathered momentum towards the end of 2008, with expectations for the first quarter of 2009 even worse and at their lowest level since the survey began fifty years ago. The January survey noted that domestic orders fell at their fastest rate since the early 1980s. The survey also indicated that the sharp decline in exports continued despite the depreciation of sterling, with the collapse in overseas demand and aggressive destocking being the dominant influence in the short term.

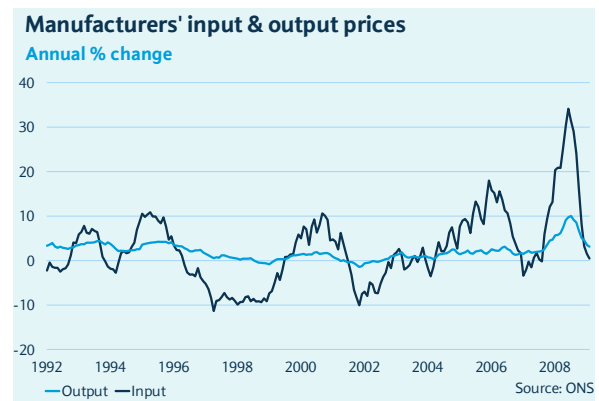


Nevertheless, the sharp depreciation of sterling over the past few months, against both the euro and the dollar, means that UK output is now increasingly competitive in both the domestic and export markets. However, the impact of this boost to competitiveness is being undermined as the global economy continues to slow. UK export volumes have fallen sharply, although there is some evidence to suggest that they are remaining more resilient than in other European countries, which may partly be due to the depreciation of sterling.

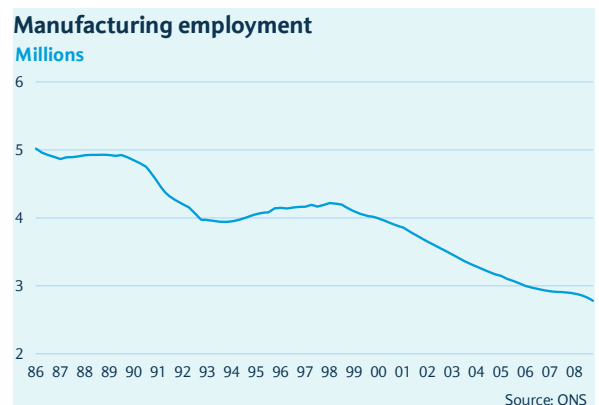
Costs and prices

Booming energy and commodity prices underpinned a surge in input costs during most of 2008. However, following the collapse in oil and metal prices, cost pressures have abated subsequently and in February the annual rate of growth slowed to just 0.5%. Even so, the weak value of sterling is now mitigating the impact of lower commodity prices and input costs actually rose by 0.6% between January and February (a second consecutive month of price increases).

Manufacturers were slow to push through price increases and, after peaking at 10% in the summer, growth in output prices slowed to 3.1% in February.



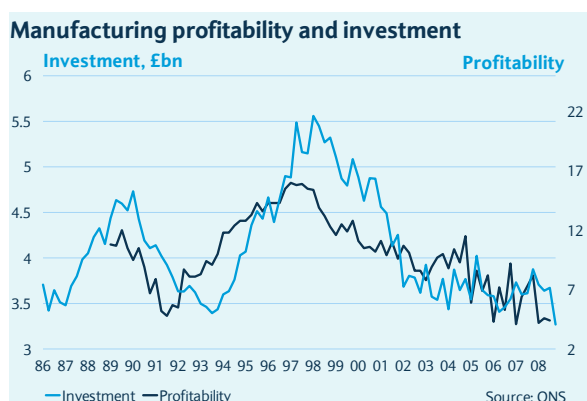
Employment



The long-term downward trend in manufacturing employment continues, with the rate of decline accelerating to 4.2% in the fourth quarter. Anecdotal evidence suggests that towards the end of last year a number of manufacturers were striving to avoid costly redundancy arrangements,

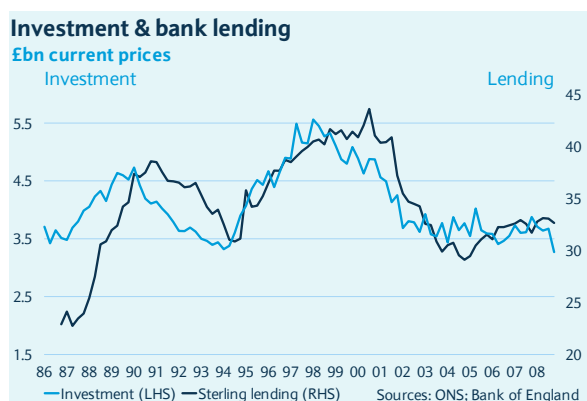
opting to adjust shift patterns (moving to four day weeks and cutting shifts at nights and weekends) and deferring wage settlements and freezing pay levels. However, job losses are expected to intensify over the next few months.

Profitability and Investment



Profitability came under considerable downward pressure last year, as the cost of inputs surged and demand fell back. Despite the fact that cost pressures have since abated, the sharp contraction in demand means that there has been little relief on margins.

Official statistics show that business investment fell sharply in the fourth quarter of 2008, down by 15.7% on the same time a year earlier, having been relatively resilient in the first three-quarters of last year. The latest quarterly CBI Industrial Trends survey found that capital investment intentions have been scaled back at their fastest rate since the survey began in 1958.



Bank lending and deposits

Total outstanding loans and advances to the manufacturing sector rose by 25.2% in the year to the fourth quarter 2008, according to data from the Bank of England (see chart for sector trends). However, this was largely due to a rise in non-sterling lending (which was impacted by the depreciation of the pound) as sterling lending increased only marginally. The sharp rise in lending to the food, drink & tobacco, and mechanical engineering & transport equipment sectors, were both nearly all as a result of an increase in non-sterling lending.

Bank lending by sector

£ million	Q4 2007	Q4 2008
Food, Drink & Tobacco	13,515	18,676
Textiles & Clothing	1,407	1,588
Pulp, Paper, Printing & Publishing	7,022	7,735
Chemicals, Pharmaceuticals & Plastic Processing	5,095	7,003
Building Products & Metals	6,594	8,036
Mechanical Engineering & Transport Equipment	7,461	10,605
Electrical, Electronics & Instrument Engineering	3,767	4,483
Other	6,482	6,148
Total	51,344	64,273

Sterling and foreign currency lending to UK residents

Source: ONS

Deposits by the sector fell by 4.2% in the year to the fourth quarter according to data from the Bank of England, which is likely to reflect continuing pressure on the sector's cashflow.

Outlook

Prospects remain very poor for manufacturers in the near term with output continuing to be depressed by what seems like a particularly aggressive bout of destocking throughout the supply chain. Overall, given the weakness in the opening months of the year, we expect production to decline by 5-6% in 2009. Two factors seem to be particularly important for the prospects of the manufacturing sector for the remainder of 2009. First, how quickly stocks are reduced to desired levels: even an end to destocking, rather than a beginning of restocking, would be beneficial to the output of the sector. And second, the extent to which manufacturers are able to take advantage of their increase in competitiveness resulting from the sharp depreciation of sterling in both export and the domestic markets.

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All data and factual information referred to in this report were
correct as of 26th March 2009

Source of ONS data: National Statistics website:
www.statistics.gov.uk

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