UK manufacturing officially in recession

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Britain's manufacturing sector is in a recession. Figures released this week by the Office for National Statistics showed that manufacturing output fell for the second successive quarter, the official definition of a recession. For the three months to June, output fell by 2 percent on the previous three months and by 1.3 percent year-on-year.

The UK manufacturing sector has been in trouble for some time, partially due to the high value of the pound, and has shed 100,000 jobs in the last year alone. However, warnings that the slowdown in the world economy, particularly in the US, would hit the UK hard have previously been dismissed. Government officials argued that with a strong service sector and consumer spending remaining buoyant, the British economy was fundamentally sound and would be able to weather an adverse international climate.

Such complacency is now being punctured. The US slowdown has been accompanied by signs of growing economic weaknesses in the euro zone, particularly in Germany, where industrial production fell by 0.4 percent in June, amidst forecasts that growth of the country's economy—Europe's powerhouse—would fall from 3 percent last year to just over 1 percent this year.

The US and Germany are Britain's major export markets. Consequently, the number of profit warnings posted by companies in the UK has risen sharply over the last period. At the end of July, shares in Invensys, one of Britain's largest engineering groups, fell by 15 percent and prompted its third profit warning in ten months. Earlier, the British owned Marconi electronics group had warned that its operating profits would fall by 50 percent this year. In July the company announced 4,000 job losses worldwide, in addition to almost 3,000 job cuts already announced in April.

Responding to the latest figures, Ian Fletcher, chief economist at the British Chambers of Commerce, said, "What is particularly alarming is the breadth of impact across the sector, with both new and old industries now facing tough times. Our manufacturers are caught between a rock and a hard place, with the pain of the global slowdown, accentuated by an uncompetitive euro exchange rate."

In the first quarter of this year manufacturing investment fell by 2.7 percent. Investment in IT spending, which accounts for almost 25 percent of total business investment, was severely cut back during the second quarter. According to the Confederation of British Industry, the proportion of firms working below capacity is the highest since 1993.

At the same time, increased imports pushed the UK's trade deficit with non-EU countries to £10 billion in June, £1 billion more than in the same month last year and the widest gap on record.

A survey by the consultancy Business Strategies published Tuesday, warned of serious job losses over the coming months. Employment in manufacturing could fall by as much as 38 percent in areas such as the North East it said, but the sharpest falls were likely in the south east and London, where it forecast a decline of 43 percent.

In a surprise move last week, the Bank of England Monetary Policy Committee cut interest rates by a quarter of a percent. For months, the Policy Committee had resisted calls for an interest rates cut, mainly from industry and the trade unions. The Bank of England's turn around came amidst signs that the slowdown in manufacturing is spreading to other sectors of the economy.

In its statement, the Bank said that the outlook for growth had deteriorated since its last report in May, due to worsening conditions in the world economy. There was no sign of a turn around coming until 2002, the Bank continued, but warned that, "the possibility that the slowdown in the international economy may be deeper or more prolonged remains a downside risk."

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It is not just the manufacturing sector that is in trouble. London's financial and business service sector, which accounts for 40 percent of the capital's output, is also experiencing a slowdown. The Centre for Economics and Business Research estimates that 10,000 jobs have gone from the City's workforce of 300,000 in finance and related services over the last year due to the weakening financial markets. Falling share prices have meant that the sales of individual savings accounts, heavily promoted by the government, fell by 28 percent in the first half of this year, whilst corporate finance suffered a sharp decline as the number of takeovers involving British companies fell from 702 to 470 in the first half of the year.

Growing fears over job security and financial indebtedness have begun to make themselves felt in consumer spending. Retail sales stagnated in terms of volume in June, depressing the year-on-year rate from 6.5 percent in May to 5.6 percent.

Attention is now focussed on the housing market. Most of the wealth of UK families is tied up in housing rather than in shares, and the housing market has undergone a record boom over the past year, with house prices rising on average by £20 a day. This has almost reached the same level that existed just before the sudden collapse of the housing market in the late 1980s, which left millions of families with negative equity—paying off a far higher mortgage than their home was worth on the open market—resulting in record numbers of repossessions. Some analysts are warning that a similar scenario is just around the corner.

The sombre forecasts have led many of the UK's leading economic advisers to call for a major devaluation of the pound. The *Financial Times* July 13 wrote that the one conviction uniting Britain's policymakers was the need for a "hefty" sterling devaluation, by up to 15 percent. "A steep fall in the pound's value is as inevitable as it is necessary. The only question is how fast and how far sterling will eventually slide—and how much havoc it will wreak on the way down", Phillip Stephens wrote.

In an unprecedented call last month, economists from the Ernst & Young ITEM Club (one of the UK's best-known independent economic forecasting groups) urged the Bank of England to take drastic action. Professor Peter Spencer, ITEM's economic adviser, warned that the present situation was "so precarious" that "unless the pound falls soon, you are going to see bodies falling out of the window in a big way".

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