

INTRODUCTION

The Q2 2008 results are ominous, and highlight serious risks of UK recession. Most balances have recorded sharp falls, and some are at historically low levels. In manufacturing, key balances for home sales and orders, employment expectations, and cashflow fell sharply and moved into negative territory. The investment and confidence balances, while positive, also recorded big declines. The improvement in export balances, though welcome, does not make up for the sharp deterioration in virtually all other manufacturing balances. In services, the Q2 balances recorded even bigger declines overall than in manufacturing. Home sales and orders, and cashflow, are down sharply and are in negative territory. Other service balances are positive, but recorded Q2 falls: for exports, employment, and investment. Overall, the Q2 results point to worsening dangers of outright falls in output.

DOMESTIC MARKET

The manufacturing sector's balance for home sales plunged 15 points in Q2, to -3%, lowest since Q4 2001. The net balance for manufacturers' home orders dropped 13 points in Q2, to -5%, also lowest since Q4 2001.

The service sector's domestic balances recorded alarming declines in Q2, and the falls were bigger than in manufacturing. The net balance for home sales declined 19 points, to -2%, lowest since Q3 1992. The net balance for home orders fell 21 points, to -7%, lowest equal since Q4 1990.

EXPORT MARKET

The manufacturing sector's export performance strengthened in Q2. The export sales balance increased 12 points to +28%, highest since Q3 2007. The export orders balance rose 6 points to +22%, also strongest since Q3 2007. The service sector's export balances weakened markedly in Q2, in contrast to the manufacturing improvement. The export sales balance fell 8 points to +9%, lowest since Q3 2005. The balance for export orders fell 4 points to +6%, lowest since Q3 2003. The service sector's export performance is disturbingly weak.

EMPLOYMENT

The employment balances weakened in Q2. The manufacturing employment balance fell 6 points to +3%, lowest equal since Q1 2006. The employment expectations balance plunged 10 points, to -1%, lowest equal since Q4 2002. In the service sector, the employment balance dropped 9 points to +7%, lowest equal since Q1 2003. The employment expectations balance plunged 13 points to +8%, lowest since Q4 1993.

INVESTMENT

The Q2 balance of manufacturing firms planning to increase investment in plant & machinery plummeted 10 points to +2%, lowest equal since Q1 2002 and worryingly weak. Intentions to invest in training

dropped 10 points to +11%, lowest since Q3 2003. In services, the balance of firms planning to increase investment in plant & machinery fell 3 points to +5%, lowest since Q1 2003. Intentions to invest in training fell 10 points to +14%, a record low.

BUSINESS CONFIDENCE

The confidence balances fell sharply in Q2. The manufacturing sector's turnover confidence balance dropped 11 points to +32%, lowest since Q4 2001. Profitability confidence plunged 22 points to +5%, weakest since Q3 1998. The service sector's turnover confidence balance plummeted 23 points to +17%, lowest since Q3 1992. Profitability confidence plunged 16 points to +1%, a record low last seen in Q4 1990.

CAPACITY UTILISATION AND CASHFLOW

The Q2 balance of manufacturing firms operating at full capacity was unchanged, at +40%. In services, +38% of firms worked at full capacity, down 4 points. Both cashflow balances dropped to record lows in Q2, and both are in negative territory: manufacturing plunged 12 points to -15%; services plummeted 15 points, to -10%.

PRICES

The balance of manufacturing firms reporting pressure to raise prices rose 3 points in Q2, to +45%, a new all time high. In services, the balance of firms expecting to increase prices fell 2 points to +41%, still a very high level.

ECONOMIC CLIMATE

The Q2 QES results signal a menacing deterioration in UK prospects. Most manufacturing balances and virtually all service sector balances, worsened. For the first time in many years, the vital balances for domestic sales and orders, and for cashflow, have moved into negative territory for both manufacturing and services, underlining serious risks of recession. The threats are amplified by plunging confidence balances across both sectors. Some key balances, mostly in services, are at historically low levels not seen since the early-1990s recession. Intentions to raise prices remain elevated, rising to a new peak in manufacturing and easing only slightly in services. But weak demand and relentless squeeze on disposable incomes will thwart attempts to secure big price increases. The MPC faces difficult choices. But immediate threats to growth are more alarming than dangers of higher inflation. With cashflow balances at record lows, credit crunch is a real threat. A major recession can be avoided, but forceful corrective action is needed to improve confidence. The MPC must resist misguided calls for higher interest rates. If wage pressures remain muted, the option of early rate cuts must be considered. On its part, the Government must alleviate acute business concerns over new taxes and regulations, and must stand ready to support vulnerable small businesses.