

INTRODUCTION

The Q2 2009 results show welcome progress but also highlight serious risks. Most critical national balances improved in Q2, for both manufacturing and services, but almost all the key balances remain in negative territory, and most balances are still weak by historical standards. The manufacturing balances recorded stronger improvements in Q2 than those of the service sector, but, in absolute terms, the manufacturing balances are still weaker overall. The most positive feature of the Q2 survey is the marked strengthening of all the confidence balances, albeit after exceptionally sharp declines in the previous two quarters. Confidence levels are still weak by historical standards, and the recent improvement can only be sustained if the economy continues to stabilise and the recession ends. With cashflow, capacity utilisation, and price pressures remaining weak, it is important that the short-term policy stance continues to be expansionary.

DOMESTIC MARKET

The manufacturing sector's balances improved markedly in Q2. The net balance for home sales rose 18 points, to -37%. The balance for manufacturers' home orders rose 15 points, to -37%. Both Q2 domestic manufacturing balances are still historically weak, and remain much worse than those of the service sector.

The service sector's domestic balances also improved in Q2, but they remain weak by historical standards. The net balance for home sales moved up seven points, to -16%. The net balance for service home orders rose five points, to -24%. The Q1 service balances are much stronger than those of manufacturing.

EXPORT MARKET

The export position is stronger for manufacturing and broadly stable for services. The manufacturing export sales balance rose 11 points in Q2, to -16%. The manufacturing export orders balance improved 20 points, to -8%. The service export sales balance rose one point in Q2, to -10%. The service export orders balance fell two points, to -12%. The Q2 service export balances remain very weak by historical standards.

EMPLOYMENT

All the employment balances remain in negative territory, and all remain weak by historical standards. The manufacturing sector's employment balance fell one point in Q2, to -37%, the lowest since records are available in Q1 1989. But the manufacturing employment expectations balance improved 19 points, to -16%. The service sector's employment balance rose three points in Q2, to -15%. The service employment expectations balance also improved three points, to -9%.

INVESTMENT

The investment balances improved in Q2, but they remain weak by historical standards, and most are still in negative territory. The balance of manufacturing firms planning to increase investment in plant and machinery rose eight points to -30%. Manufacturers' intentions to invest in training rose four points to -15%. In services, the balance of firms planning to increase investment in plant and machinery improved three points, to -18%. Service intentions to invest in training rose six points, to 0%.

BUSINESS CONFIDENCE

All the Q2 confidence balances show a significant improvement, but they are still very weak by historical standards. The manufacturing sector's Q2 turnover confidence balance rose 40 points to +2%. Manufacturers' profitability confidence also rose 40 points, to -8%. The service sector's turnover confidence balance rose 19 points, to +7%. Service profitability confidence rose 24 points to +1%.

CAPACITY UTILISATION AND CASHFLOW

Capacity utilisation remains weak. The Q2 figure of manufacturing firms operating at full capacity was unchanged, at 20%. In services, 34% of firms worked at full capacity, down four points. Cashflow balances are very weak by historical standards and remain in negative territory. The manufacturing cashflow balance was unchanged in Q2, at -32%, lowest level since records are available. Services cashflow improved nine points to -17%.

PRICES

Pressures to raise prices remained very weak in Q2. The balance of manufacturing firms reporting pressure to raise prices rose one point to -6%. In services, the balance of firms expecting to increase prices fell two points in Q2 to +1%.

ECONOMIC CLIMATE

The Q2 results confirm that the pace of decline in the UK economy is clearly easing. The worst phase of the recession is over, but serious downward pressures persist across all sectors and regions. In spite of marked Q2 improvements, almost all the key balances are still in negative territory, and most balances remain weak by historical standards. Talk of recovery is premature. Further corrective measures are needed to support the economy. The marked improvement in confidence, albeit from exceptionally low levels, is welcome. Confidence levels are still historically weak, and recent improvements can only be sustained if the economy continues to stabilise and the recession ends. With cashflow, capacity utilisation, and price pressures remaining weak, it is important that the short-term policy stance continues to be expansionary. Sustaining the recovery, and preserving Britain's international credit rating, depends critically on the adoption of a credible medium-term strategy for improving our public finances and nurturing wealth-creating businesses.