

INTRODUCTION

The Q3 2009 results show improvements in all the key national balances, for both manufacturing and services. The results support the view that the decline in activity is ending. But the economy is still frail, and a sustainable recovery cannot be guaranteed. Some key balances - home, employment, investment in plant and machinery, and cashflow - are still negative in both sectors. Manufacturing employment expectations remain negative. On the positive side, the confidence balances have strengthened in both sectors, with manufacturing confidence registering a very strong improvement. In the service sector, the export balances and the employment expectations balance are now positive. Overall, the Q3 results are encouraging. But the economy faces serious risks, and time-limited corrective measures are still needed.

DOMESTIC MARKET

The domestic national balances strengthened significantly in Q3, particularly for manufacturing, but all remain in negative territory. The manufacturing sector's net balance for home sales increased 27 points in Q3, to -10%, the highest level since Q2 2008. The balance for manufacturers' home orders strengthened 28 points, to -9%, also the highest level since Q2 2008. The service sector's net balance for home sales rose 15 points in Q3, to -1%, the highest level since Q1 2008. The service net balance for home orders rose 14 points, to -10%, the highest level since Q2 2008.

EXPORT MARKET

The export position strengthened in Q3, for both manufacturing and services, but balances remain weak by historical standards. In both sectors, export balances are stronger than home balances. The manufacturing export sales balance rose 16 points, to 0%, the strongest level since Q3 2008. The manufacturing export orders balance improved 4 points, to -4%, the equal strongest level since Q2 2008. The service export sales balance rose 16 point in Q3, to +6%, the highest level since Q3 2008. The service export orders balance rose 15 points, to +3%, also the highest level since Q3 2008.

EMPLOYMENT

The employment balances improved in Q3, but they remain weak by historical standards. The manufacturing employment balance improved 18 points, to -19%, the highest level since Q4 2008. The manufacturing employment expectations balance rose 11 points, to -5%, the highest level since Q2 2008. The service employment balance rose 9 points, to -6%, the highest level since Q3 2008. The service employment expectations balance improved 14 points, to +5%, the strongest level since Q2 2008.

INVESTMENT

All the investment balances improved in Q3, but remain weak by historical standards. The balance of manufacturing firms planning to increase investment in plant and machinery rose 12 points to -18%, the strongest result since Q3 2008. Manufacturers'

intentions to invest in training rose 11 points to -4%, also the strongest level since Q3 2008. In services, the balance of firms planning to increase investment in plant and machinery improved 9 points, to -9%, the highest level since Q3 2008. Service sector intentions to invest in training rose 6 points, to +6%, the highest level since Q2 2008.

BUSINESS CONFIDENCE

All the Q3 confidence balances show significant improvements, particularly for manufacturing. The manufacturing turnover confidence balance climbed 34 points in Q3, to +36%, the strongest figure since Q1 2008. Manufacturers' profitability confidence rose 29 points, to +21%, also the best level since Q1 2008. The service sector's turnover confidence balance improved 13 points, to +20%, the highest level since Q1 2008. Service profitability confidence rose 8 points to +9%, also the highest level since Q1 2008.

CAPACITY UTILISATION AND CASHFLOW

Capacity utilisation remains relatively weak. The Q3 balance of manufacturing firms operating at full capacity was up 7 points, at +27%. In services, +34% of firms worked at full capacity, unchanged since last quarter. Cashflow balances remain in negative territory and are still weak by historical standards. In manufacturing, the cashflow balance improved 22 points, to -10%, the strongest level since Q1 2008. Services cashflow improved 9 points, to -8%, also the strongest level since Q1 2008.

PRICES

Pressures to raise prices strengthened in Q3, but remain weak. The balance of manufacturing firms reporting pressure to increase prices rose 6 points, to 0%. In the service sector, the balance of firms expecting to raise prices increased 14 points in Q3, to +15%.

ECONOMIC CLIMATE

The Q3 results, which show improvement in all the key national balances, support our assessment that the UK economy is on the brink of recovery. But the improvement is not sufficiently strong to allow us to conclude without doubt that the economy has returned to positive growth. With critical balances still negative in both sectors, the recovery that is now starting is fragile and vulnerable. Persistent weakness of bank lending to businesses poses clear dangers, and the MPC must act to address this issue. Job losses threaten the country's skills base. A sustainable recovery has to rely on the ability of businesses to invest and export.

Britain's credit rating depends critically on the adoption of a credible multi-year plan for improving our public finances without damaging wealth-creating businesses. Unless the business sector is nurtured and empowered to take the economy out of recession, the country will face serious risks of further decline.