

**Introduction**

The Q1 2006 results signal progress in both sectors, with services showing the bigger improvement. But the upturn in the economy is fragile, and many threats persist. The manufacturing sector recorded improvements in its Q1 balances for home sales and orders, export sales and orders, employment expectations, and plant and machinery investment. But the sector recorded declines in its balances for employment, cashflow, and profitability confidence. Manufacturing has persistently failed to sustain recovery, and the Q1 confidence balances are disappointing and worrying. Recent signs of upturn are very tentative, and the sector faces acute threats. Service sector Q1 performance improved in most areas, but many results remain mediocre. Balances for home sales and orders, export sales and orders, employment and employment expectations, plant and machinery investment, and both confidence balances all rose in Q1. But the service sector's improvement in Q4 and Q1 was from a low base, and prospects remain uncertain.

**The Domestic Market**

The manufacturing sector's domestic balances improved further in Q1 2006, but the results are still relatively weak. The Q1 net balance for national home sales rose 2 points to +15%. The Q1 net balance for home orders rose 10 points to +13%. But sales as well as orders were still lower in Q1 2006 than in Q2 2005, and lower than in most quarters of 2004.

The service sector's domestic balances also strengthened in Q1 2006. The net balance for home sales rose 4 points in Q1 to +22%, highest since Q1 2005 but still lower than in all 4 quarters of 2004. The net balance for service sector home orders rose 8 points to +18%, but was still lower than in all 4 quarters of 2004.

**Export Market**

The manufacturing sector's export performance improved markedly in Q1. The export sales net balance rose 11 points to +23%, highest since Q1 2005. The export orders net balance rose 15 points to +22%, highest since Q3 1996. The service sector's export performance also improved markedly in Q1. The net balance for export sales rose 19 points to +29%, highest since Q4 1996. The service sector's net balance for export orders rose 17 points to +26%, highest since Q4 1994.

**Employment**

The manufacturing employment Q1 balance fell from +7% to +2%, lowest since Q3 2003. The employment expectations balance rose from +5% to +12%, highest since Q1 2005. In the service sector, the Q1 employment balance rose 1 point to +12%, still a low level. The employment expectations balance rose 11 points to +27%, highest equal since Q2 2004.

**Investment**

The balance of manufacturing firms planning to increase investment in plant and machinery rose 7 points in Q1 to +15%, highest since Q4 2004. Intentions to invest in training remained unchanged, at +18%. In services, the balance of firms planning to increase investment in plant and machinery rose 7 points to +15%, highest equal since Q3 2004. The balance for intentions to invest in training rose 3 points to +26%.

**Business Confidence**

The manufacturing sector's net balance of turnover confidence was unchanged in Q1 at +43%, a relatively low level by historical standards. Manufacturing profitability confidence fell 7 points in Q1 to +21%, lowest since Q4 2001. The service sector's turnover confidence rose 4 points in Q1 to +51%, still lower than in Q1 2005. The service sector's profitability confidence rose 3 points in Q1 to +33%, still lower than in Q1 2005 and lower than in all 4 quarters of 2004.

**Capacity Utilisation**

The proportion of manufacturing firms operating at full capacity rose 3 points in Q1 to +38%. In services, 36% of firms worked at full capacity, down 3 points.

**Cashflow and Prices**

Manufacturing cashflow fell 10 points in Q1 to 0%. Services cashflow was unchanged at +7%. The balance of manufacturing firms reporting pressure to raise prices fell 5 points in Q1 to +22%. In services, the balance of firms expecting to raise prices fell 1 point in Q1 to +27%.

**Economic Climate**

The welcome progress in Q4 and Q1, follows a very marked deterioration in the first 3 quarters of 2005. The UK upturn is very tentative and businesses face acute risks. Growth has been well below trend in recent quarters, and there is a distinct risk that unemployment will rise further. Manufacturing Q1 balances recorded improvements in home sales and orders, export sales and orders, employment expectations, and plant and machinery investment. But the sector recorded declines in its balances for employment, cashflow, and profitability confidence. In spite of the recent tentative upturn, manufacturing faces acute threats. Service sector Q1 performance improved in most areas, but the many results remain mediocre. Balances for home sales and orders, export sales and orders, employment and employment expectations, plant and machinery investment, and both confidence balances all rose in Q1. But the service sector's Q4 and Q1 improvement was from a low base, and prospects remain uncertain. The UK upturn is very fragile and needs to be nurtured. Without supporting action there is danger of renewed relapse. We urge the MPC to maintain a flexible stance. The Government on its part must act more aggressively to reduce the oppressive regulatory burden, and must make it clear that additional tax increases on business will not be contemplated.