Maintaining the squeeze on costs becomes vital for manufacturing

By Peter Marsh

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Stephen Moon has been doing his bit to keep Britain's inflation figures low.

As the chief executive of The Vehicle Application Centre, a Lancashire-based company and one of Britain's leading makers of fire engines, Mr Moon says cutting costs is a way of life in manufacturing.

"To survive in this business, you have to be better, quicker and cheaper than the competition. You have to cut costs and prices by around 5 per cent a year," he says.

In the past few years, achieving such goals has become important not just to factory managers but economic policymakers including Gordon Brown, the chancellor, and Mervyn King, governor of the Bank of England.

The cost-cutting efforts of people such as Mr Moon - operating factories either in the UK or abroad - have been crucial to maintaining inflation at a much lower rate than in previous years.

In the five years to 2004, the goods component of the consumer prices index - the Bank of England's chosen inflation target - has fallen by an average of 0.7 per cent a year, while the services component of the index has gone up by an average of 3.5 per cent annually.

With the CPI's goods component accounting for 55 per cent of the index's total weighting, the price falls for products have been largely responsible for the year-on-year increase in the CPI staying at less than 2 per cent between 1997 and 2004, within the Bank's guidelines.

Last year, however, the CPI rose to an annual rate of 2.1 per cent. In May this year it increased again to 2.2 per cent, prompting warnings from both Mr Brown and Mr King about the need for vigilance over signs of rising prices.

A big factor behind the jump in the May inflation figure was that the goods component of the CPI rose in that month by a year-on-year 1.3 per cent, its biggest increase since December 1996.

Last year, the goods component of the CPI rose 0.3 per cent, the first time the year-on-year change in this figure had turned positive since 1999.

A further recent sign of goods inflation edging up was the 3 per cent year-on-year increase in May in another inflation measure monitored by the government - the producer price index. This covers prices of products made in UK factories and sold to industrial users or consumers both in the UK and overseas.

Behind the recent indications of inflationary pressures in factories, whether in Britain or abroad, have been hefty rises in prices of energy and commodities such as plastics and copper.

While these have added to manufacturers' costs, many companies have also taken the opportunity to increase prices to push up profit margins on the back of strong global demand for manufactured products over the past three years.

There have also been signs that wage costs in China, which last year sold £13.2bn of exports to the UK, mainly goods, and a figure six times higher than a decade ago, are starting to rise, so helping to push up prices of some China-made products from a low base.

The signs of inflationary pressures in manufacturing are real enough - and the fact that they are bothering people such as Mr King and Mr Brown means they have to be taken seriously.

Even so, such are the pressures on manufacturing that few believe global prices of factory goods are likely to show any large upward shift in the foreseeable future. That will leave UK manufacturers having to cope as best they can in an environment in which cost pressures are intense.

In the case of TVAC's Mr Moon, he says that his company has been able to cut its own costs, so maintaining its competitive effort, through ideas such as improved production techniques, including new ways to build the bodies of fire appliances with plastic parts and using fewer assembly steps.

Through such measures it plans to double its output of fire engines within the next year to about 140.

However, as a result of productivity increases, it will need to add only an extra 70 or so people to its 130-strong workforce.

Patrick Thornhill, the managing director of Richardson of Sheffield, a South Yorkshire-based knife manufacturer, says that the answer to competitive pressures has been to transfer much of his company's manufacturing from the UK to countries such as China and Vietnam where it can be done much more cheaply.

For XP Power, a maker of power supply equipment, based in Berkshire, a way to avoid some of the price effects has been to target relatively specialist parts of this market where the pressures are less.

"In our end of the industry, we still have to cut costs so that we reduce the price of our equipment by perhaps 2 per cent a year," says James Peters, the deputy chairman of XP.

"But that is not nearly as harsh as in the consumer electronics part of the power supply sector, where the annual price falls are likely to be more like 20 per cent," he adds.