

'G4' developed economies

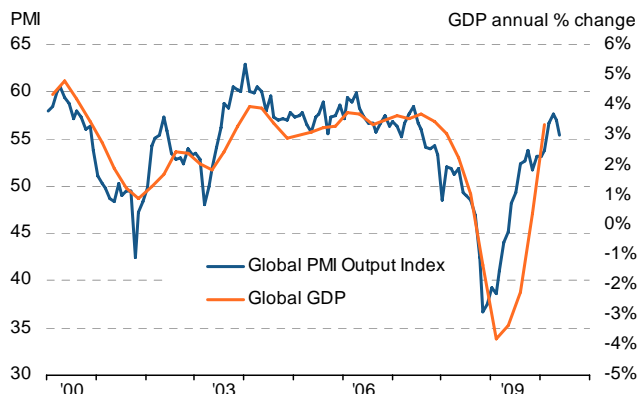
Slower inflows of new orders and weakness in the service sector pose risks to growth after buoyant second quarter

Earlier this year we reported how the global recovery was at a 'critical juncture', whereby 'unless service sector growth can accelerate to offset the waning stimulus from the manufacturing inventory cycle, global economic growth may weaken in coming months.' There is an increasing risk to growth in that the service sector is failing to take up the baton from manufacturing.

Global economic growth picked up in Q2

The JPMorgan Global PMI Output Index, compiled from national PMI manufacturing and service sector survey data by Markit, fell to a four-month low of 55.4 in June, down from 57.0 in May but remaining high enough to round off the strongest quarter of growth for three years (the quarterly average rose from 54.5 in Q1 to 56.7 in Q2). Our analysis suggests that the latest quarterly average reading of the PMI is consistent with global GDP growth accelerating slightly in Q2 on the estimated 3.4% pace seen during the first three months of the year.

Global economic growth



Sources: Markit, JPMorgan.

The downturn in the headline Global PMI is not altogether surprising. The high level the index had attained in recent prior months was no doubt unsustainable, reflecting a temporary bounce-back in business conditions from record weakness during the height of the recession.

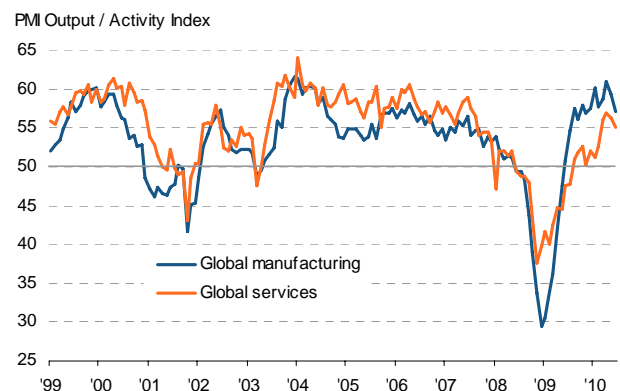
Manufacturing consolidates from highs

However, this argument only really stands for manufacturing, which saw a deeper downturn and sharper rebound than services. Having reached a near-record high in April, growth of manufacturing output in June was the weakest for seven months, but the index remains at an elevated level by historical standards of the survey, consistent with industrial production rising globally at an annualised rate of approximately 7%.

Services fail to attain pre-recession growth

More worrying is the failure of the service sector to regain the rate of growth seen prior to the financial crisis. What's more, the service sector expanded globally at the weakest rate for four months in June.

Manufacturing v. services output



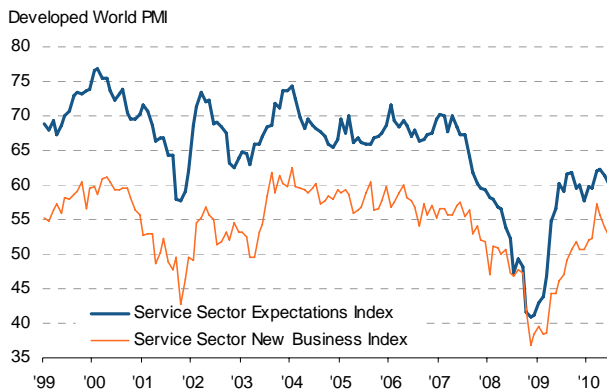
Sources: Markit, JPMorgan.

For many developed countries the recovery has simply failed to spill over from manufacturing to services, as domestic demand remains subdued by high levels of debt and uncertainty regarding looming austerity measures required to trim budget deficits. Inflows of new business have even begun to fall again in some developed countries, including Germany, Spain and Japan. The developed country services PMI surveys

collectively pointed to a slowdown in new business growth for the third successive month in June.

Measured across all main developed countries (excluding the US), expectations about the year ahead in the service sector fell to a four-month low in June and is running at a level seen only once before prior to the recession – when confidence slumped in response to the 9/11 terrorist attacks.

Developed World PMI surveys

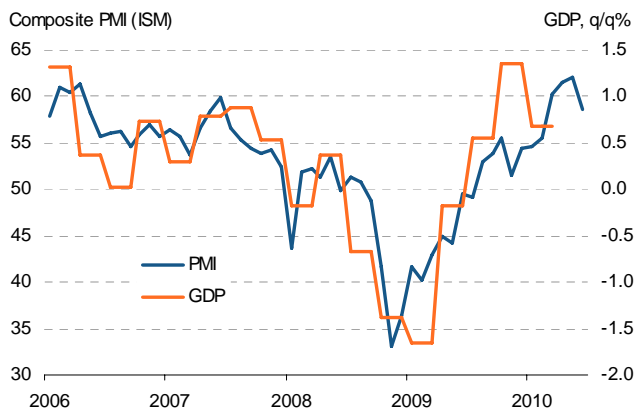


Sources: Markit, ISM.

United States

In the United States, the weighted average of the ISM's manufacturing and non-manufacturing output indices fell for the first time in seven months in June but growth for both sectors remained strong by historical standards of the surveys¹. The data are broadly consistent with GDP rising at an underlying annualised rate of 1% in Q2.

United States GDP



Sources: Markit, ISM, Ecwin.

¹ It should be borne in mind that the ISM-produced US PMI surveys are different to those of other countries in that the 'services' survey covers all non-manufacturing, including the state sector.

Some moderation in US growth in Q3 looks likely due to the recent downturns in the new business indices and the fact that the non-manufacturing sector has underperformed relative to the buoyant manufacturing economy in the recovery. Manufacturing new orders posted the weakest rise for eight months in June, while a six-month low was seen in non-manufacturing.

United States new orders¹

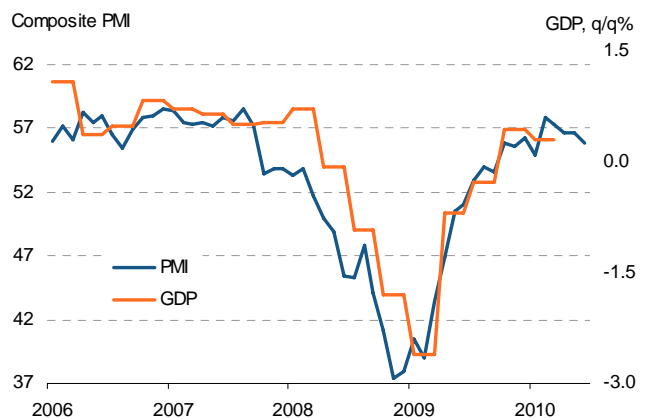


Sources: ISM.

United Kingdom

The Markit/CIPS PMI surveys collectively point to GDP increasing at a rate of approximately 0.5% in Q2. However, the all-sector² index slipped to a five-month low in June. Manufacturing new orders rose at the slowest pace for seven months and growth of service sector new business remained well below pre-recession levels. It is likely therefore that growth will slow as we move into the second half of the year, especially as public sector austerity measures loom.

United Kingdom GDP²



Sources: Markit, CIPS, ONS.

² UK GDP comparison includes construction in the PMI surveys as well as manufacturing and services.

United Kingdom new orders



Sources: Markit, CIPS.

Eurozone new orders



Source: Markit.

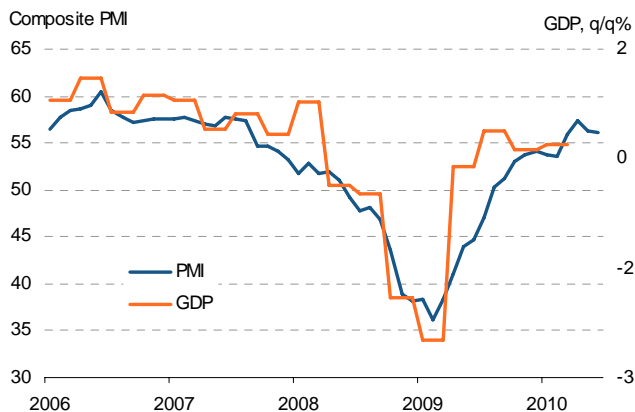
Eurozone

The Eurozone PMIs are roughly consistent with a 0.5%–0.6% increase in GDP in Q2, but a weakening trend was apparent during the quarter. Manufacturing new orders showed the smallest rise so far this year, while services grew at the weakest rate for four months.

Only France is showing broad-based resilience in its all-sector PMI numbers although, even here, manufacturing new orders growth has weakened in recent months. Spain reported a renewed downturn in new business and Italy saw inflows of new business moderate for the third month running.

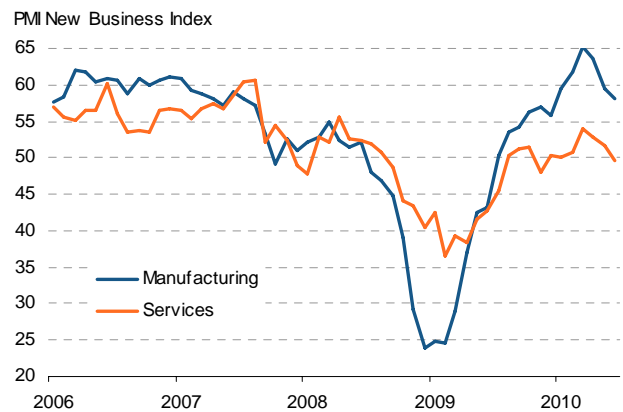
However, perhaps of most concern was a fall in new business in the German service sector (the first decline since November), which occurred alongside a slowing in manufacturing new orders growth to the weakest so far this year.

Eurozone GDP



Sources: Markit, Eurostat.

Germany new orders



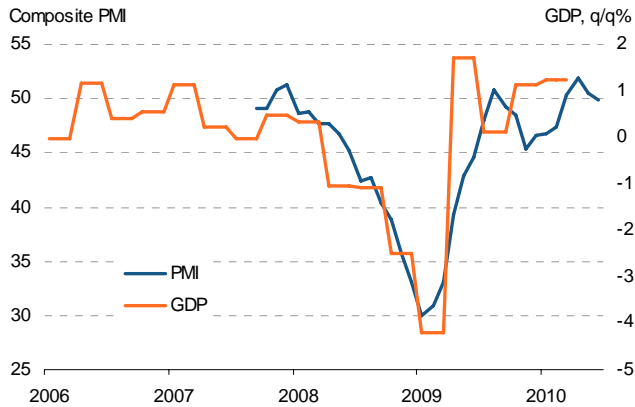
Source: Markit.

Japan

With its GDP numbers volatile and subject to major revision, it has been difficult to gauge the country's recovery. The PMI has shown a 'w' shaped recovery so far, and another slowdown is becoming apparent as we move into the second half of the year.

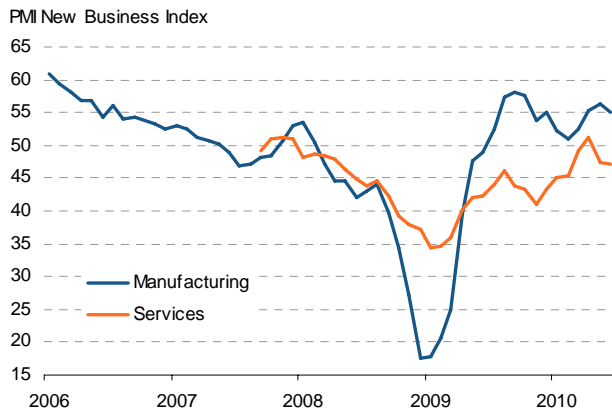
The manufacturing sector has benefited from the improvement in global trade flows, but looks set to suffer as these flows cool in coming months. Meanwhile, the service sector PMI is showing ongoing contraction (new business fell at the fastest rate for four months in June.)

Japan GDP



Sources: Markit, Nomura, Ecwin.

Japan new orders



Sources: Markit, Nomura, JMMA.

Increased risks of further slowdown

The disappointing service sector performance in recent months has left many countries reliant upon further growth of manufacturing exports to sustain their economic expansions. However, with global trade beginning to slow again (as highlighted by the fall in the JPMorgan Global PMI Manufacturing New Export Orders Index to a six-month low in June and the HSBC China PMI New Orders Index dropping below 50), the manufacturing sector's role as a driver of growth looks set to diminish further in coming months. The risk of double-dip recessions has therefore increased for the most vulnerable countries, particularly those facing severe fiscal tightening, including several European countries as well as Japan.

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