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Markit Economic Research

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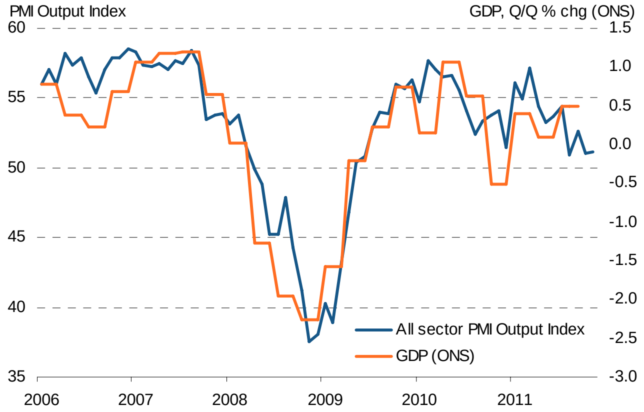
UK economy

PMI™ surveys signal stagnation with risk of further weakening to come

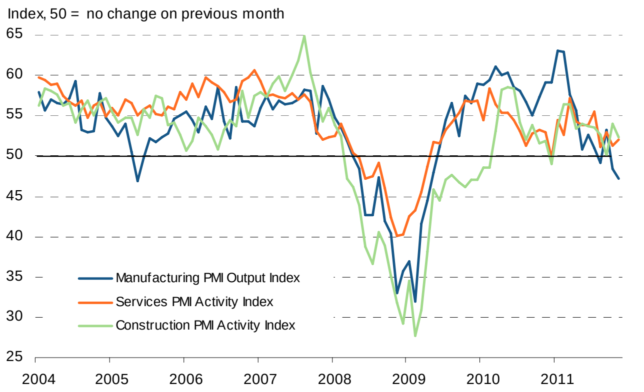
- **PMIs point to Q4 economic stagnation**
- **Modest growth in services and construction offset by manufacturing downturn**
- **Uncertain outlook with risks to the downside**

Modest expansions in the UK service and construction sectors offset a steep contraction of manufacturing output in November, but the end result was only very modest growth of overall economic activity during the month. The weakness signalled by the PMI surveys suggests that the economy is likely to stagnate in the final quarter of 2011. Whether or not the UK slides into contraction early next year remains highly uncertain, but the risks currently appear to be on the downside.

All sector PMI and GDP



Output by sector



The weighted average of the output indices from the three Markit/CIPS PMI™ surveys rose slightly from 51.0 in October to 51.1 in November. Despite the up-tick, the average PMI reading so far in the fourth quarter is the weakest since the second quarter of 2009, when the UK recession was just ending. The data indicate gross domestic product (GDP) is likely to have stagnated in the final quarter of the year, although the December reading could tip the balance in either direction.

A further modest expansion of **services** activity in November indicated that business was holding up in the face of growing gloom about the health of the domestic economy and heightened uncertainty regarding the euro area's debt crisis. However, these headwinds are clearly taking their toll as, so far, services are seeing the weakest quarter of growth since the spring of 2009. The survey data are roughly consistent with the sector expanding 0.3% in the fourth quarter.

Construction sector activity also rose modestly in November, buoyed by improved levels of residential and commercial building. As with services, the rate of expansion was only modest but nevertheless suggests that construction made a small positive contribution to economic growth in the final quarter.

The principal area of weakness in the UK economy appears to be **manufacturing**, where the surveys showed output contracting at the steepest pace since April 2009. The final quarter is looking set to be the weakest since the opening quarter of 2009, with the sector shrinking by around 1.5%.

Although manufacturing only accounts for just over 10% of the UK economy, the steep decline in the goods producing sector will offset the modest growth in services and construction, leaving a picture of overall economic stagnation in the final quarter of 2011.

Unusually uncertain outlook

The surveys also showed that companies remained concerned about the outlook, not least because inflows of new business barely rose, posting the joint-smallest increase since new orders began rising in July 2009.

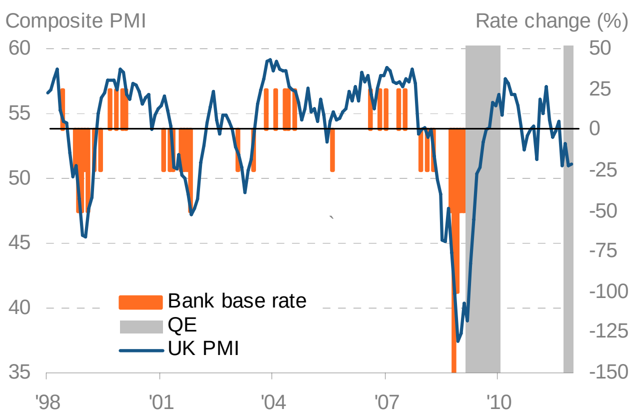
Companies also cited concerns about the impact of domestic austerity measures and the unusual uncertainty being generated by the euro area debt crisis. Headcounts across the private sector fell at the steepest rate for over a year as a result.

With the private sector cutting staff at the same time as government spending cuts reduce public sector payroll numbers, unemployment looks set to rise above the current rate of 8.3%.

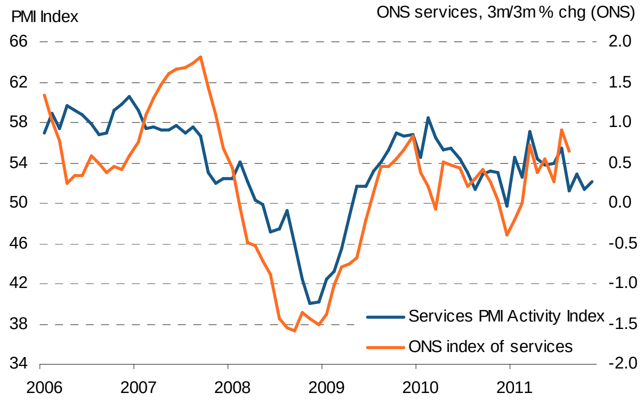
Job market weakness will inevitably hit consumer spending. The impact may be offset if inflation eases, thereby reducing the current squeeze on real incomes (prices are rising by 5% per annum whereas average salaries are increasing by just 2.3%). The PMI surveys show that average prices charged for goods and services fell for the first time in almost two years in October, and were broadly unchanged in November. This is in distinct contrast to the strong rates of increase seen earlier in the year.

Domestic economic conditions therefore appear to be finely balanced between expansion and contraction. Whether or not the economy slides into recession next year probably depends on whether politicians can find a workable solution to the Eurozone crisis. Until then, uncertainty is likely to prevail, which is damaging to both business and consumer confidence and raises the risk of the UK sliding back into a new downturn in the opening quarter of next year.

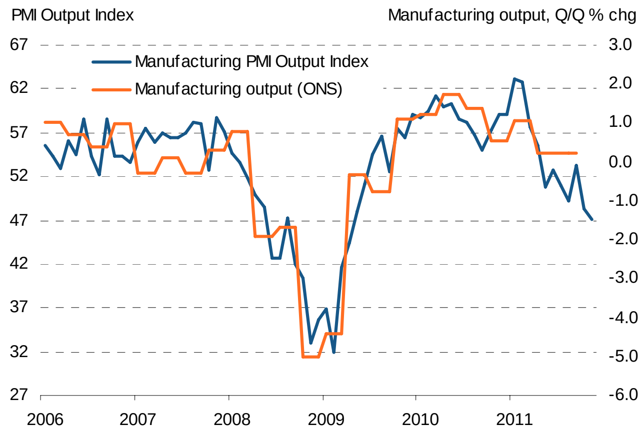
PMI and Bank of England rate setting



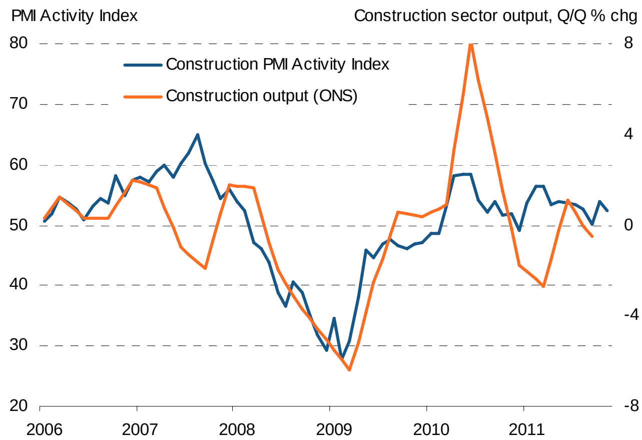
Service sector output



Manufacturing output



Construction activity



Sources for charts: Markit, ONS, Ecowin, Bank of England.

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