

# UK economy

## PMIs rebound to signal strongest growth for eight months in January

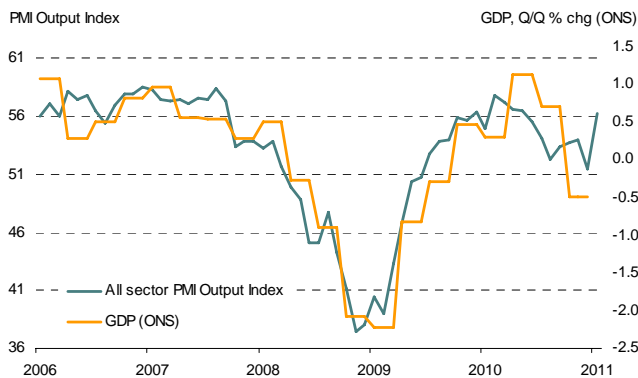
- **Growth picks up in January but underlying trend remains weak.**
- **Services and construction rebound from snow-related disruptions, but fail to match manufacturing growth spurt.**

The Markit/CIPS PMIs showed a rebound in activity in January, raising hopes that the economy will return to expansion in Q1, having posted a surprise 0.5% contraction in the final quarter of last year.

However, the PMIs also showed an economy moving at two speeds. Weak underlying growth in the services and construction sectors are acting as drags on the economy, suggesting that the recovery remains fragile and reliant upon strong growth in the relatively small manufacturing sector.

The combined output/activity index from the three PMI surveys jumped from an 18-month low of 51.6 in December to an eight-month high of 56.2 in January. At 53.9, the average reading over these two months – which provides a better guide to the underlying trend – suggests that the UK economy continued to expand at the start of the year but that the rate of growth was only modest. The data are consistent with a quarterly rate of GDP growth of approximately 0.4%.

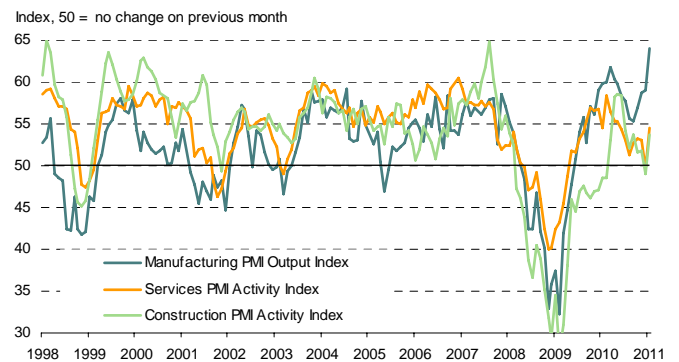
### GDP and the PMI



While 0.4% growth would represent a marked improvement on the shock 0.5% contraction of GDP in the final quarter of last year, it is well below the strong

rates seen earlier last year and comparable growth rates in other developed countries, such as Germany and the United States.

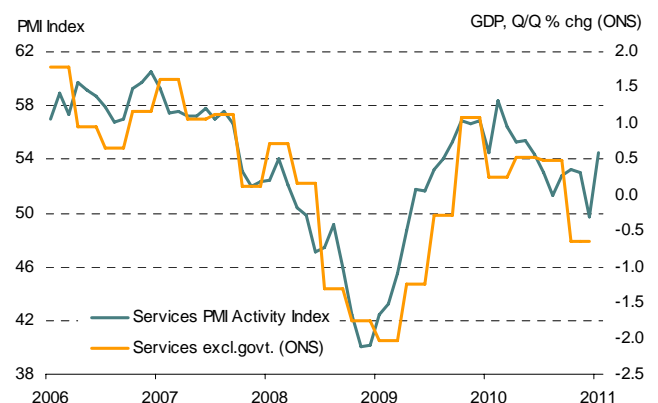
### PMIs – output growth by sector



### Subdued services, despite bounce-back

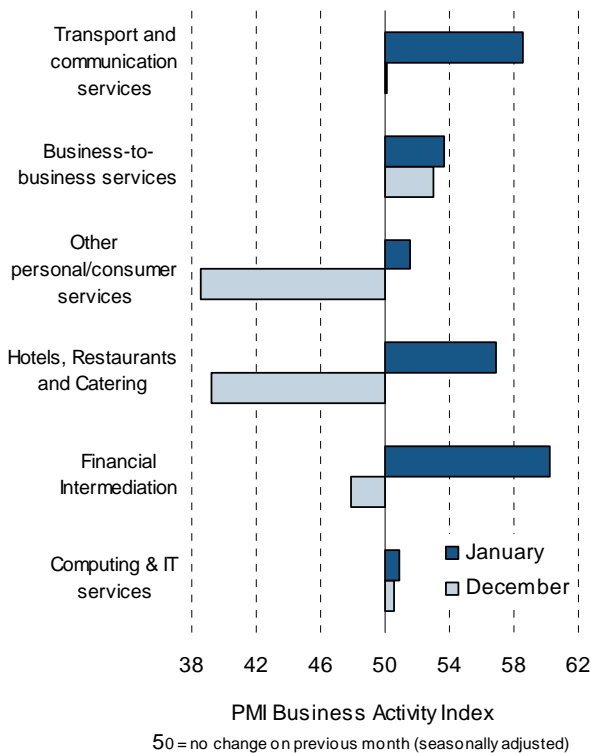
The PMI showed that growth had slumped in the service sector during December as bad weather hit trade in areas such as travel, transport, restaurants and hotels – registering the first contraction for 20 months. Activity naturally bounced back in January as the country thawed, with growth climbing to an eight-month high. However, with the services' Activity Index averaging just 52.1 across the two months of December and January, the data suggest only modest service sector GDP growth of approximately 0.2% (by comparison, the index averaged 55.8 in the decade prior to the financial crisis).

### Services (non-government) activity



As well as expected strong rebounds in transport & communications, consumer services (such as theatres and cinemas) and hotels, restaurants & catering, financial intermediation also saw a surprisingly strong upturn in January, contrasting with declines in both November and December. Business services and computing & IT have meanwhile shown a less volatile trend in recent months, with the former registering only a slight pick up in its modest growth rate in January, while the latter recorded only a marginal rise in activity. The subdued rates of growth in these two sectors suggest that, while growth has picked up in line with stronger manufacturing expansion since a lull last autumn, the rate of expansion remains subdued.

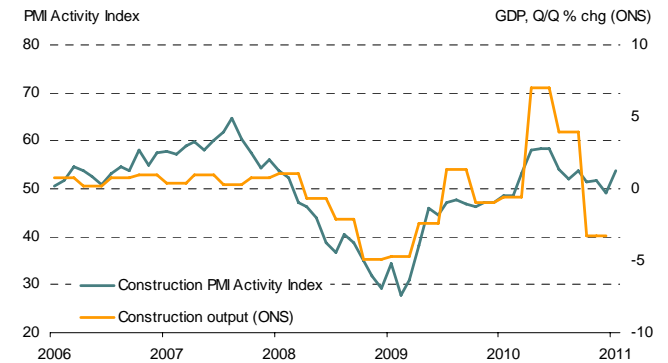
**Services activity growth by broad sub-sector**



**Construction**

A similar situation to services is evident in construction, where the PMI signalled a dip in activity in December (the first decline for ten months), while January saw the strongest increase for four months. However, looking across both months, the data indicate only a marginal increase in activity, with the pace well down on the growth surge seen in spring last year.

**Construction activity**

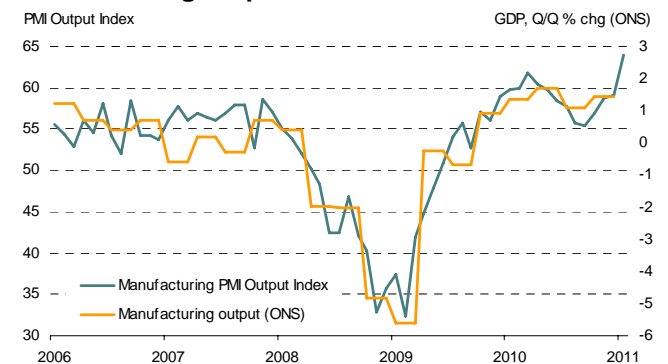


**Manufacturing growth spurt**

In contrast to services and construction, the manufacturing sector has moved up a gear in recent months, benefitting from strong export demand in other countries plus the near-25% weakening of sterling compared to early-2007. The sector's PMI jumped to its highest level in the survey's near-20 year history in January, fuelled by record growth in new orders and a near record increase in production. The rise built on a strong end to 2010. Apparently undaunted by adverse weather, the UK's manufacturers notched up the strongest expansion since mid-1994 in December. This suggests strongly that the sector's record increase in January cannot simply be explained as a rebound from lost activity in the previous month.

We estimate that the rate of growth signalled by the PMI in January is running at approximately 2.5% per quarter – a truly impressive pace and up sharply from the 1.5% expansion seen in the GDP data for Q4 that the survey had accurately anticipated.

**Manufacturing output**



**Weak employment trend**

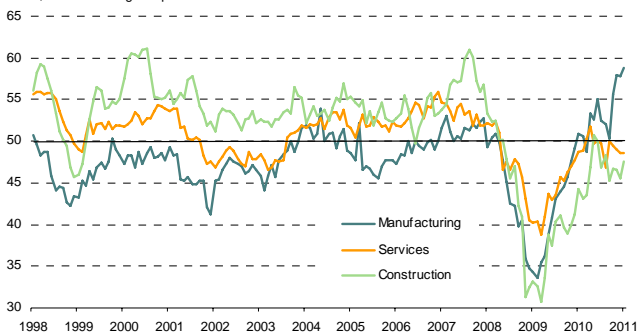
The manufacturing PMI's Employment Index also provided encouraging news, hitting a record peak in January, having dipped only slightly in December from

a previous record seen in November. Such consistent strong employment growth indicates not only the need to expand capacity to meet demand but also a degree of confidence that order books will continue to improve in coming months.

Employment continued to fall in both services and construction, however, almost entirely offsetting the improvement seen in manufacturing. The Employment Index for all three sectors registered just 50.5 in January, up from 50.0 in December.

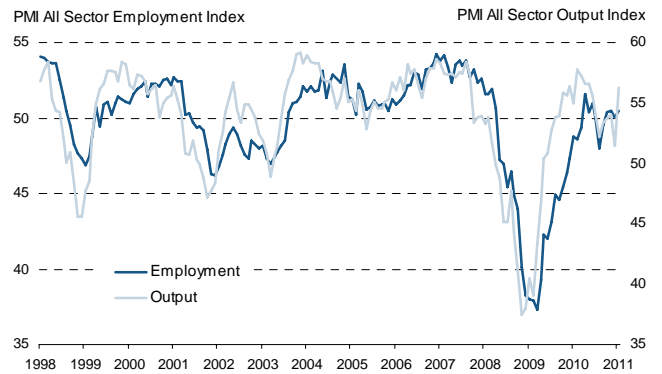
**PMI Employment indices**

Index, 50 = no change on previous month



**PMI employment and output**

Sources for all charts: Markit, ONS.



**Bumpy road ahead**

With manufacturing accounting for a mere 13% of total output in the UK economy, compared to 76% for services (52% if government services are excluded), it is likely to take some time before output and employment growth in the goods producing sector is likely to be sufficient to drive a robust rate of expansion of UK GDP. In the meantime, we may need to get used to news-flow showing a bumpy, two-speed, recovery.

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