

UK Economy

PMI™ surveys point to sharp growth slowdown in April

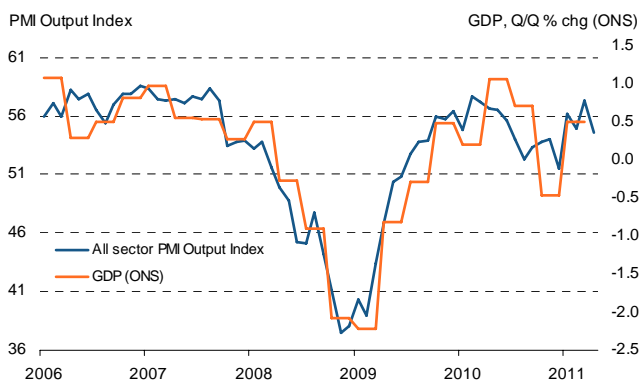
- Largest fall in all-sector PMI Output Index since collapse of Lehmans signals GDP growth of just 0.4% at start of Q2.
- Greater than usual uncertainty over outlook.
- Slower growth of input costs suggests inflation spike may prove transitory.

The three April UK PMI surveys collectively indicated the largest loss of growth momentum seen since just after the collapse of Lehmans in late-2008. However, a myriad of factors is causing an unusually high degree of uncertainty in relation to gauging the strength of economic growth in Q2, including the performance of the construction sector, signs of order book growth slowing rapidly in manufacturing, the impact of government spending cuts, plus unusual weather and public holidays.

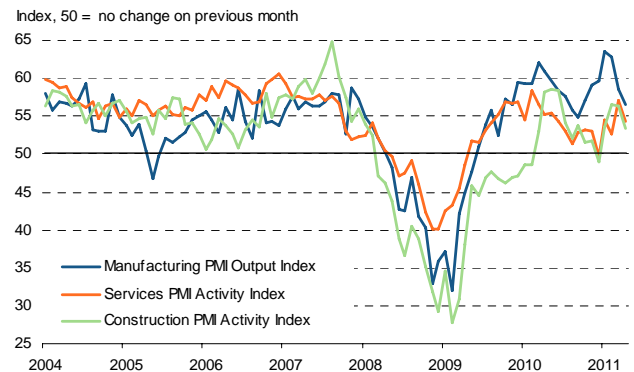
Growth slows in all three PMI surveys

Output indicators from each of the three UK PMI surveys fell in April. Consequently, the weighted average of the surveys showed the largest monthly fall since November 2008, dropping from a 12-month high of 57.3 in March to 54.6, to register the weakest monthly expansion since December. The surveys therefore suggest that, having risen 0.5% in Q1, gross domestic product (GDP) growth lost significant momentum at the start of Q2. We estimate the quarterly growth run rate to have slowed to 0.4% in April from 0.8% in March.

All-sector PMI and GDP



PMI Output Indices



Unusually high uncertainty

This suggests that if the all sector PMI remains at its current level in May and June, GDP looks set to rise by just 0.4% in Q2. However, there are a number of factors which create uncertainty around both this estimate and the government's estimate of GDP in Q2.

The greatest uncertainty hinges around the performance of the construction sector. April's construction PMI showed the Output Index dropping for the second month running to the lowest level since December. But the construction PMI survey had contrasted with official data in Q1, showing a rebound from the snow-related disruptions late last year instead of the 4.7% decline indicated by the more volatile official numbers. Without this decline in construction, GDP would have risen by 0.8% in Q1, not 0.5%. It is therefore possible that the official construction data for Q2 could actually boost GDP in Q2 by showing a rebound from this peculiarly steep Q1 drop.

Second, in manufacturing, where the PMI data had tallied reasonably closely with the government's estimate of 1.1% growth in Q1 (though the PMI had signalled a slightly stronger increase), the Output Index fell for the third month running in April from January's 16½ year high, registering the weakest pace of expansion since September. The uncertainty for the rest of the current quarter rests on an even sharper drop in the survey's New Orders Index, which suggests

that the production trend will continue downwards in May.

In services, where the PMI had been broadly consistent with the 0.9% increase in output signalled by the Q1 GDP data for the sector, the Activity Index fell from March's 13-month high to signal the weakest growth since February. More worryingly, the fall in the index was the second largest since October 2008, exceeded only by the sector's weather-related slide back into contraction in December.

For manufacturing and services (and construction, according to the PMI), growth in Q1 was also boosted by the return to better weather following the worst December in 100 years. It is not clear how much growth may then weaken in Q2 as a result of business returning to normal. Nor is it clear how business would have been affected by last month being the hottest April on record.

In services, growth in Q1 also appeared to have been boosted by increased government spending, as budgets were used up to a greater extent than usual prior to the financial year-end. This effect appears to have gone into reverse in April, as widely anticipated.

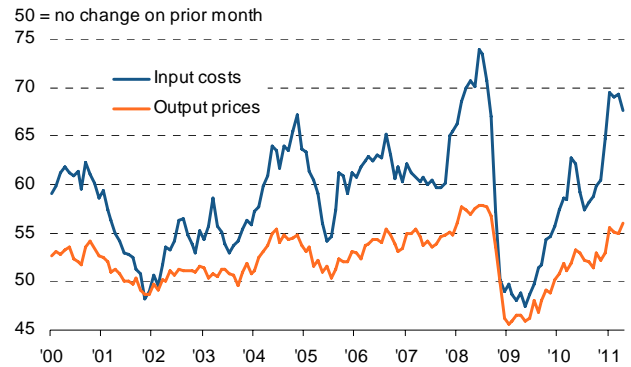
Finally, uncertainty in relation to both PMI and official data also rests with the impact of the supply chain disruptions emanating from the earthquake in Japan, the timing of Easter and the additional bank holiday for the royal wedding.

This uncertainty, plus the modest rate of growth suggested by the PMIs, adds weight to the belief that policymakers at the Bank of England will err on the side of caution at the next two meetings at least, choosing to wait for a clearer picture of the pace of economic growth to emerge.

Mixed signals on inflation

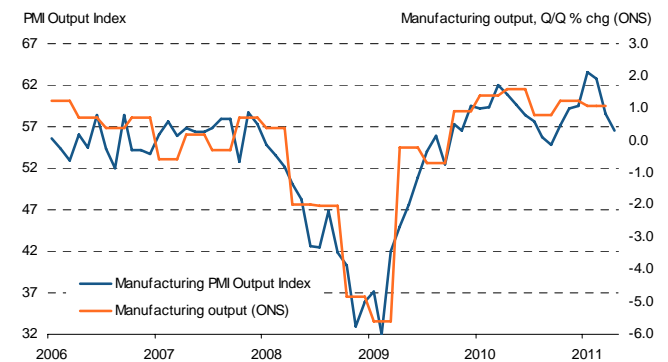
Where policymakers may grow concerned is the increase in prices charged for goods and services signalled by the April PMI surveys, which was the largest since the oil-price related spike in September 2008. However, even on the inflation front, the Bank's belief that the current strong inflationary pressures should prove transitory is lent support by the PMIs. The all-sector PMI measure of input costs eased to a four-month low in April, cooling especially sharply in manufacturing, where input price inflation showed the sharpest slowing since November 2008. Weaker cost pressures should in theory feed through to lower selling price inflation in coming months.

PMI Prices Indices (all sectors*)

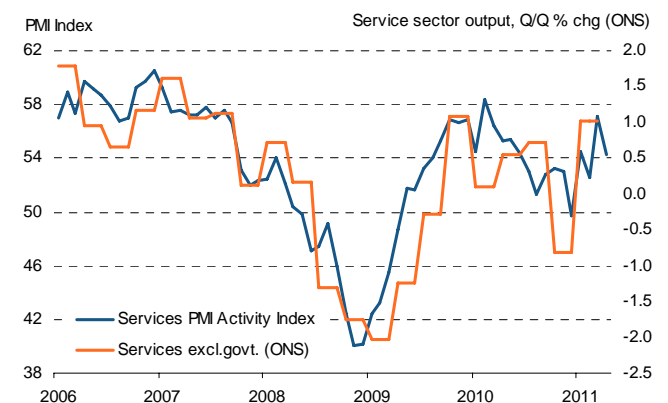


* Output prices exclude construction.

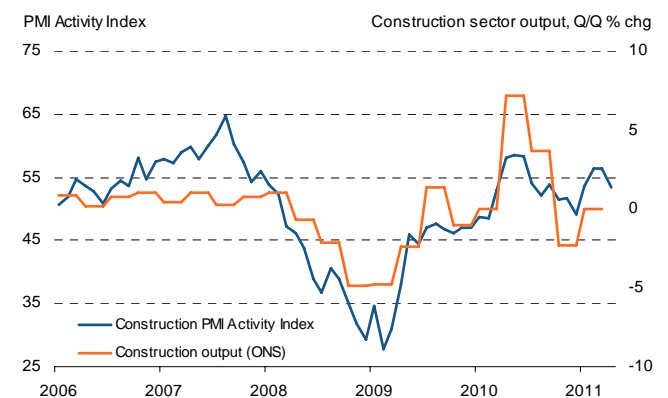
Manufacturing output



Service sector output



Construction output



Sources for all charts: Markit, ONS.

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