

UK manufacturing

Manufacturing set for slide back into recession

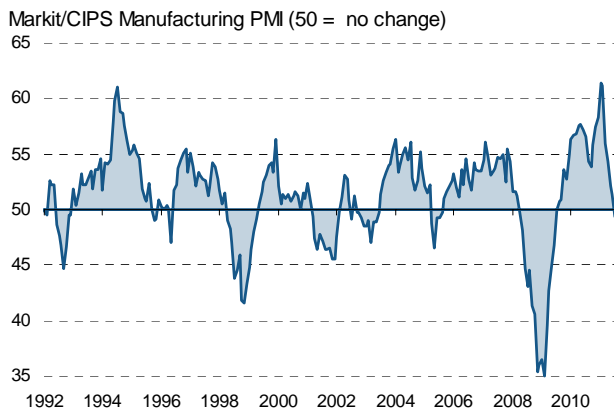
- **Weak PMI data for August raise the risk of manufacturing contracting for the second successive quarter in Q3.**
- **Export orders slump as index shows steepest fall for five years.**
- **Employment falls, with job losses set to continue in coming months.**

The latest UK PMI survey showed business conditions deteriorating in August, with manufacturing set to slide back into recession and act as an increasing drag on the country's economic recovery in the third quarter. A steep drop in export orders exacerbated austerity-hit domestic demand. Manufacturers also look set to cut staff levels at an increasing rate in coming months as weak demand leads to cost-cutting.

PMI at 26-month low

The Markit/CIPS Manufacturing PMI fell to a 26-month low of 49.0 in August, down from 49.4 in July, to indicate a deterioration of business conditions for the second successive month. The 12-point drop in the index since the record peak in January signals a loss of momentum that has only ever been seen once before (the post-Lehmans collapse) in the 20-year history of the index.

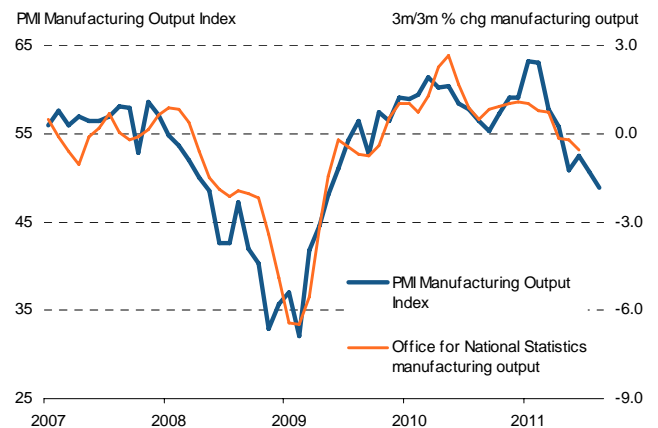
Manufacturing PMI



Manufacturing to act as increasing drag on economy in Q3

The Output Index from the PMI survey fell to its lowest level since May 2009, consistent with manufacturing output contracting at a quarterly rate of over 1.5% in August. The sector is therefore likely to act as a further drag on GDP growth over the third quarter as a whole, with the sector contracting by approximately 1.0% compared to a 0.5% decline in second quarter (which the survey had [accurately anticipated](#)). A second consecutive quarterly decline would mean the sector had entered a technical recession again.

Manufacturing output



Exports slump lower

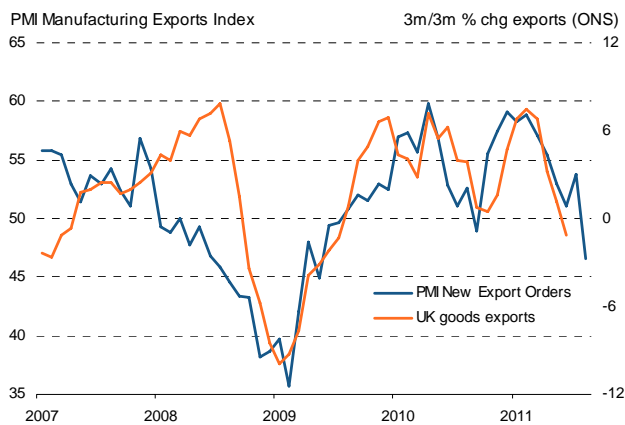
Manufacturers reported that they had been struggling due to subdued domestic demand as well as a steep deterioration in export orders. The survey's New Export Orders Index fell 7.3 index points to sit firmly in contraction territory, and at its lowest level since May 2009. The fall in the index has only been exceeded once (August 2006) since the exports question was introduced to the survey in 1996.

While data for August should be treated with caution due to the difficulty of accurately estimating the impact of holidays, especially in continental Europe, the weakening export trend comes as little surprise. Recent months have seen a steep deterioration in growth of key overseas markets, especially in the

Eurozone. PMI surveys showed manufacturing growth slipping closer to stagnation in Germany during August, while output fell in France, Spain and Italy – some of the UK’s largest trading partners.

Comparing the survey with official data, the PMI New Export Orders Index suggests that exports of goods fell at a quarterly rate of approximately 3% in August. This represents a marked acceleration from the 1.0% rate signalled by the latest available official data for June.

Exports of goods



Employment falls, with worse likely to come

Perhaps more worrying was the first reduction in manufacturing payroll numbers for almost one-and-a-half years. The New Orders Index also suggests that payroll cuts will accelerate in coming months, as manufacturers focus on reducing costs in the face of weakened demand and an uncertain future.

Employment and order books

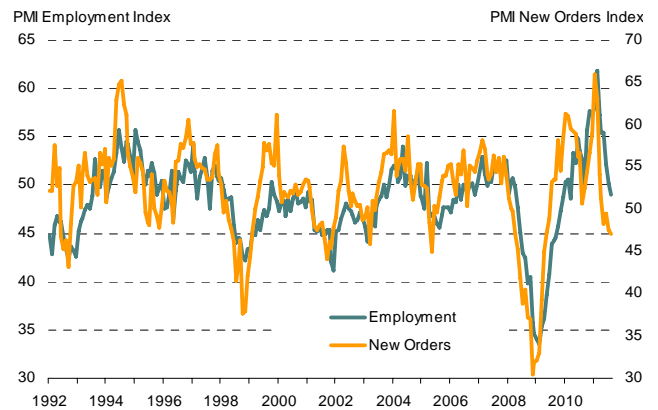


Chart sources: Markit, ONS.

Unplanned rise in stocks bodes ill for future production

Further weakness may well lie ahead. First, stocks of finished goods rose marginally. Although only slight, the increase was notable in being the first month in which inventories had not fallen for over three years. Manufacturers are likely to cut production further in coming months to allow inventories to fall again. This is especially so for consumer goods production, where the rise in stocks was the largest for 14 years.

Second, total order books fell for the fourth month running, dropping at the fastest rate since April 2009. The fall pushed the orders-to-inventory ratio (a leading indicator of production) to a 30-month low.

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