

UK PMIs

PMI data point to deepening recession. Outlook for 2009 extremely bleak.

Key findings:

- Composite CIPS/Markit data remains close to series low, consistent with 1.1% year-on-year decline in GDP.
- GDP growth for 2008 estimated at just 0.9% – weakest since 1992.
- Current forecasts for 2009 look over-optimistic.

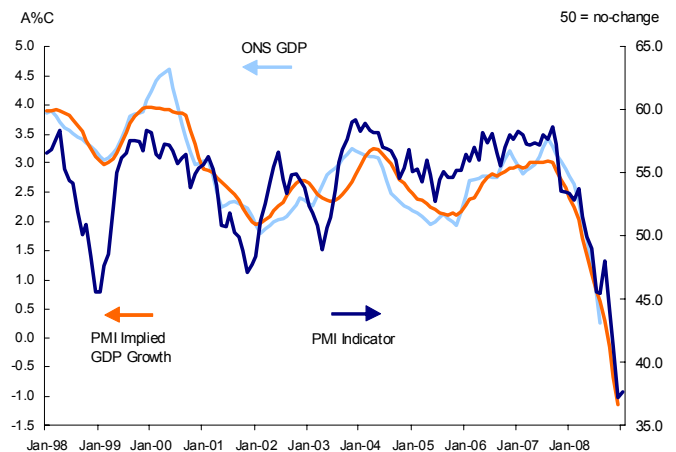
Tuesday saw the release of the latest CIPS/Markit UK services PMI data, which confirm that the UK economy is in a recession that is severe in nature. The composite PMI, which combines data on manufacturing, services and construction output, covering approximately 58% of UK economic activity, posted a level of 37.7 in December, a marginal improvement on the previous month's record low, but nonetheless still considerably inside negative territory.

Latest data are consistent with a fall in UK economic output for December of 1.1% year-on-year. Moreover, the latest findings suggest that national accounts data released later this month will show around a 0.7% contraction in GDP year-on-year for Q4, and growth for 2008 as a whole of just 0.9% – the weakest performance of the UK economy over a calendar year since 1992.

The severity of the downturn seen during the second half of 2008 has caught many by surprise. Looking at the table middle right, there have been a number of occasions when the UK manufacturing and services PMIs have come in considerably lower than economists' consensus expectation.*

Looking forward to the coming year, expectations for GDP performance over 2009 have been frantically revised down in recent weeks as economists are faced with increasingly disappointing economic data.

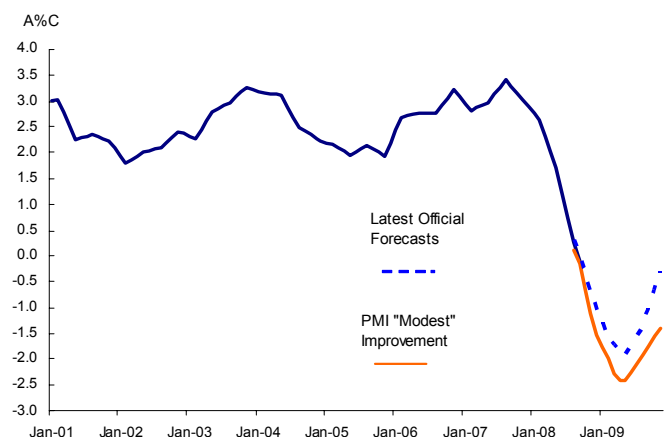
UK Composite PMI & UK GDP



UK PMIs – Consensus Performance*

	UK Manufacturing PMI			UK Services Activity		
	Reading	Forecast*	Error	Reading	Forecast*	Error
Jan-08	50.6	52.5	-1.9	52.5	52.0	0.5
Feb-08	51.3	51.0	0.3	54.0	52.1	1.9
Mar-08	51.3	51.0	0.3	52.1	53.3	-1.2
Apr-08	51.0	50.8	0.2	50.4	51.6	-1.2
May-08	50.0	50.5	-0.5	49.8	50.4	-0.6
Jun-08	45.8	49.8	-4.0	47.1	49.5	-2.4
Jul-08	44.3	45.5	-1.2	47.4	46.7	0.7
Aug-08	46.0	44.0	2.0	49.2	47.0	2.2
Sep-08	41.0	45.0	-4.0	46.0	46.0	0.0
Oct-08	41.5	40.0	1.5	42.4	44.5	-2.1
Nov-08	34.4	40.0	-5.6	40.1	41.2	-1.1
Dec-08	34.9	33.5	1.4	40.2	39.0	1.2

UK GDP in 2009 – Scenarios



In November 2007, the Treasury, the Bank of England and independent forecasters were all expecting relatively robust growth in 2009 and, crucially, an acceleration on the pace seen in 2008. However, as last year progressed, the financial crisis spread rapidly to the real economy, depressing confidence and spending to cause a widespread retrenchment of economic activity. This resulted in considerable changes to forecasts for 2008 and 2009, particularly in the second half of the year, with the Treasury, the BoE and the City all forecasting in November a fall of output in 2009 of somewhere between 0.75% and 1.25%.

But even these scaled-down forecasts already look optimistic. Using simple scenario analysis and PMI-based GDP models, in order to meet the lower bound of this forecast by following a path in GDP implied by the BoE's central projection, the composite PMI will need to recover all of the ground that it lost during 2008 – nearly 16 index points – and finish 2009 at a level of around 55.5. While not beyond the realms of possibility – given the speed in which the PMI has fallen over the past year – to put this kind of upturn into context, such a rise would surpass the previous best increase registered by the survey in the second half of 1999 by some margin

(12.8 points between November 1998 and November 1999). This seems unlikely considering the headwinds facing the UK economy of weak global demand, poorly-functioning credit markets, rising unemployment and property market losses.

However, weaker sterling, lower oil prices, the government's fiscal package and recapitalisation programme and a reduced Bank Rate should all provide some support to activity in the second half of the year. A more modest upturn in the composite PMI of around half of the ground lost in the past year seems more plausible, but provides a much grimmer assessment of economic performance in 2009.

According to this scenario, GDP would contract by around 2.0% over the year and, at the very least, match 1980's contraction of output, which is currently the worst post-war performance for a single calendar year.

**Forecasts are based on Reuters consensus view*

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