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Markit Economics Research

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UK economy

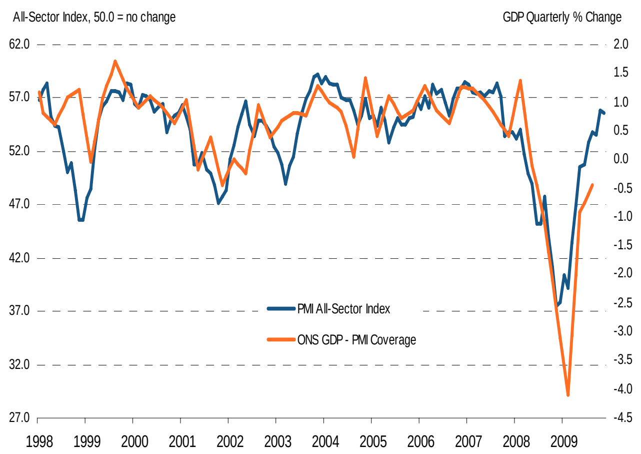
PMI data signal continuation of robust economic expansion in November

- **Composite PMI consistent with robust growth of private sector output in Q4.**
- **Near-term spike in inflation signalled.**
- **Employment closer to stabilisation.**

Growth of the UK private sector extended into a seventh successive month in November. The 'All-Sector' Output Index, which is a weighted combination of the Output Indices from the three UK PMI surveys[1] that are conducted by Markit in association with CIPS, remained comfortably above the 50.0 no-change mark. At 55.6, the index fell only slightly from October's two-year peak of 55.9.

Both manufacturing and services recorded marked gains in output during November, albeit at slightly slower rates than the two-year peaks seen in October. Meanwhile, construction sector activity declined for a twenty-first successive month, albeit at a modest pace that was the slowest since August.

All-Sector PMI and Private Sector output[2]

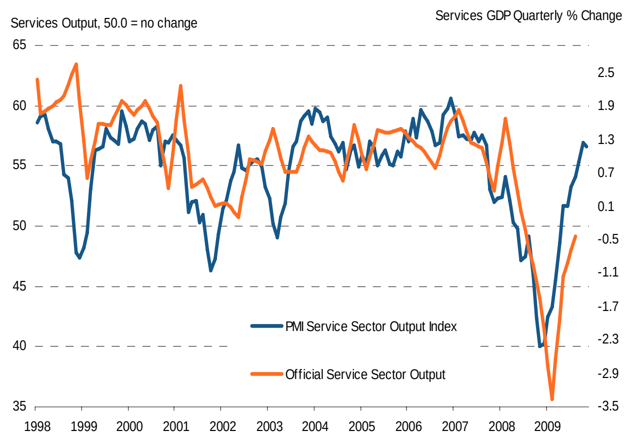


Sources: Markit, ONS

The **composite output balance is consistent with private sector growth of around 0.8% q/q in November**, and therefore continues to support the view of a rise in GDP in the final quarter of 2009.

The **private service sector, as measured by the PMI surveys,**[3] **is currently on course to deliver quarterly growth in excess of 1% for Q4 as a whole**, suggesting markedly stronger growth than currently indicated by official data for this part of the economy. Services are therefore also set to outpace manufacturing in Q4, for which PMI data indicate a quarterly rate of growth of approximately 0.6%[4].

UK Services PMI and ONS Services output



Sources: Markit, ONS

Price data support likelihood of near-term spike in inflation

The improvement in underlying growth has coincided with an increase in price pressures. Input costs rose in the service sector at the fastest rate in over a year during November, while costs in manufacturing continued to rise at a marked clip. Moreover, manufacturers registered an increase in output

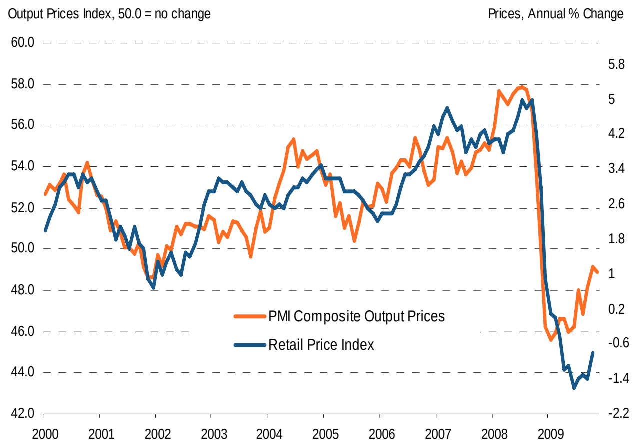
[1] Weights determined by each sector's relative contribution to the UK economy according to GDP data.
[2] Private sector output refers to those industries covered by the UK PMIs. Coverage is around 58% of the UK economy.

[3] The CIPS/Markit UK Services PMI surveys companies in the following sectors: Business Services, Financial Intermediation, Hotels & Restaurants, IT & Computing, "Other" Services, and Transport, Storage & Communications. Together, these sectors account for around 39% of the UK economy.
[4] http://www.markit.com/assets/en/docs/commentary/markit-economics/dec%2009/UK_manufacturing_09-12-01.pdf

charges for the first time in ten months, as companies fought to protect margins.

Despite competitive pressures continuing to limit pricing power, a composite output prices reading for manufacturing and services was broadly unchanged on October's 11-month high and remained comfortably above the troughs seen earlier in the year.

UK Composite Output Prices & Retail Price Index



Sources: Markit, ONS

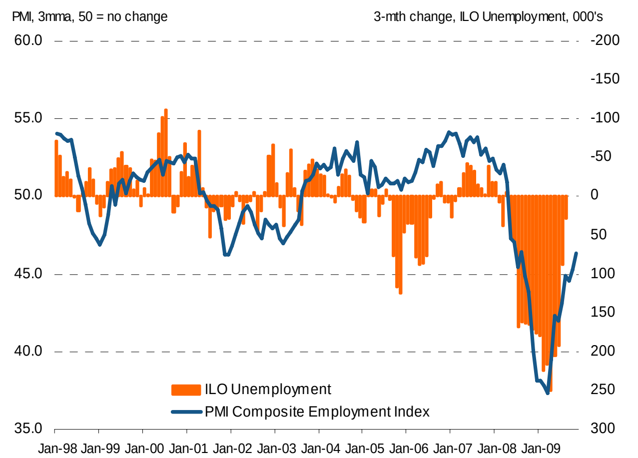
Although the latest data are consistent with a near-term spike in inflation, it seems unlikely that price pressures will continue to intensify over the medium-term. Input prices in the service sector were largely driven higher by non-core factors such as fuel and sterling effects, while inflationary pressures are likely to remain muted given the excess capacity that is prevalent in the UK economy. Moreover, any second-round impacts from higher household fuel bills are unlikely to gain traction through higher wage demands given the level of unemployment – currently 7.8% – and the subdued negotiating power this provides workers.

Private sector employment moves closer to stabilisation

Although the unemployment rate is historically high, there was evidence from the latest PMI data that the peak in jobless numbers will occur much sooner than most analysts had previously thought. November's surveys highlighted a continued easing of job losses in the UK private sector economy. The composite PMI Employment Index reached its highest level for 15 months, and moved closer to the 50.0 no-change mark that would be consistent with a stabilisation of the labour market.

The detailed data showed that manufacturers pared jobs at the slowest rate for 18 months, while service sector employment fell at the weakest pace since September 2008. Construction remained a laggard, with jobs cut at a much steeper rate than in the other two sectors (although the pace of contraction eased to the slowest in three months).

UK PMI Employment Index & unemployment



Sources: Markit, ONS

Looking forward, employment should be expected to stabilise sometime in Q1 2010 as the labour market follows output trends (typically, movements in the composite Output Index have led the Employment Index by around three months since data were first available in 1998). Currently, the difference between the two indexes is close to a record high, but this gap should begin to narrow assuming that broadly similar increases in output are maintained in the near-term. Unemployment is therefore on course to peak at a level much lower than the three million that was widely predicted by analysts earlier this year.

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