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UK economy

All-Sector UK PMI rises further above 50.0 no-change level in June, well above Eurozone neighbours

- **UK PMIs signal economic growth for second month running in June…**
- **…while Eurozone nations continue to contract.**

A weighted combination of the Output Indices from the three PMI surveys[1] that are conducted by Markit in the UK in association with CIPS shows that the output of the three sectors increased for the second successive month in June. At 51.0, up from 50.4 in May, the 'all-sector' index also indicated a modest acceleration in the rate of growth to the fastest since March 2008.

- **Manufacturers** reported the best performance of the three sectors covered, with their Output Index rising above the 50.0 no-change level for the first time since March of last year. The increase in production was in fact the strongest since February of last year. The rise was insufficient to prevent manufacturing output falling in Q2 as a whole, but the quarterly decline was the weakest since Q1 2008, with the Output Index averaging 48.1.
- **Service sector** activity increased for the second month running in June. The rate of growth remained only modest, and eased marginally on May, but the latest expansion signalled by the survey pushed the average services Activity Index for Q2 to 50.7, the highest reading since Q1 2008 and pointing to a marginal rise in activity.
- The **construction sector** continued to register the worst performance in June, with activity levels falling for the sixteenth successive month. The rate of contraction accelerated again during the month, but has eased sharply from the all-time high seen in February due to record increases in the index in April and May. At 42.8, the average index reading

[1] weights determined by each sector's relative importance according to GDP data.

Chart 1: All-Sector PMI Survey

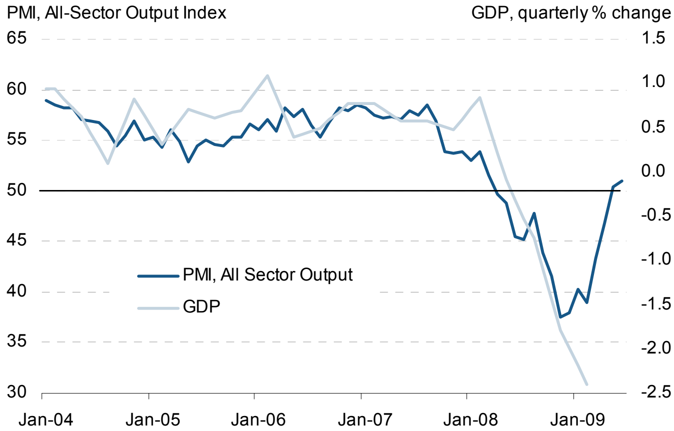


Chart 2: PMI Output by Sector

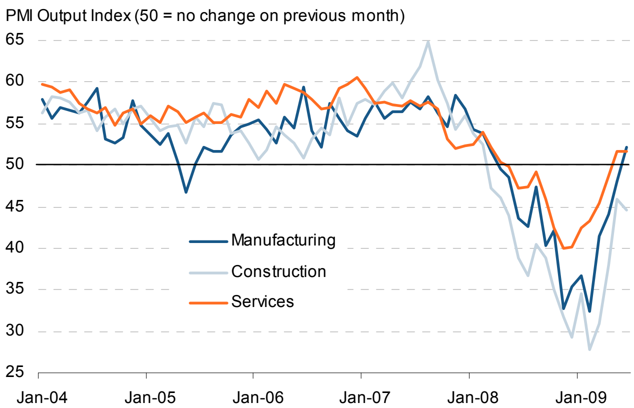
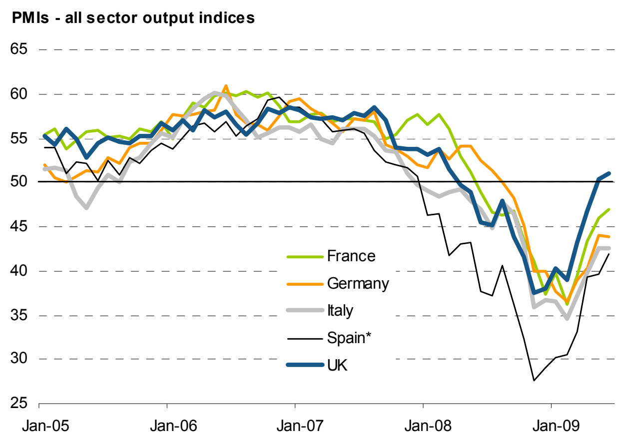


Chart 3: Country comparisons



*Spain excludes construction, included in all others.

for Q2 was well below both manufacturing and services but the highest since Q2 2008.

Rate of GDP contraction to ease sharply in Q2

The average of the PMI all-sector index for Q2 remained below the 50.0 neutral level, dragged down by the weak construction number (a composite index of the manufacturing and services sectors showed the first quarterly rise since Q1 2008, albeit only marginal). However, the rate of decline was substantially weaker than in any of the three previous quarters and the weakest since the PMI first signalled quarterly contraction in Q2 2008. The all-sector index averaged 49.4 in Q2 2009, up from 40.8 in Q1 and 39.0 in Q4 of last year. This suggests that Q2 will see a smaller decline in GDP than the 2.4% drop recorded in Q1 – which was the largest decline for 50 years.

A simple linear regression of the all-sector PMI output data against GDP indicates that, historically, the Q2 reading is in fact consistent with an increase in GDP of 0.1%. However, with the actual declines in GDP in the final quarter of last year and Q1 of this year far greater than had been signalled by the PMI, any interpretation of the stronger PMI readings in Q2 needs to be treated with extreme caution, and it seems likely that GDP will have continued to contract in Q2, but at a much reduced rate.

Encouraging picture for Q3

Although the June consolidations of recent strong gains in the services and construction PMI activity indices raise a question mark over the strength and sustainability of any recovery, other indices from the surveys present an encouraging picture for Q3. The Future Expectations Index, which tracks companies' views on their expected activity levels in 12 months' time, rose to a 22-month high in the construction sector in June and a 20-month peak in services. Meanwhile, in manufacturing, the orders-inventory ratio, which acts as a useful guide to short-term future movements in production, fell only very slightly from May's 22-month high.

Given the strength of the Q2 PMI numbers, and the positive indications for the survey output indices going forward, a return to growth for the UK economy in Q3 looks increasingly likely, assuming this has not already been achieved in Q2.

UK leads European upturn

The all-sector index for the UK was again far higher than any comparable index for the big-four Eurozone national economies, all of which saw output continue to contract in June:

- **France** saw the weakest pace of contraction of the Eurozone big-four in June, with the rate of decline moderating to the weakest since June of last year. The pace of the downturn slowed in manufacturing but gathered speed again in services and construction.
- **Germany** saw the second-weakest decline of the big-four, though the pace of contraction accelerated marginally compared to May's seven-month low. Unchanged rates of decline in manufacturing and services were accompanied by a renewed accelerated in the speed of contraction in construction.
- **Italy** saw the second-steepest downturn of the big-four countries in June, with output falling at a pace unchanged on May's seven-month low but remaining severe. Rates of decline eased in manufacturing and construction but picked up again in services.
- **Spain** continued to see the sharpest drop in output of the big-four, as has been the case since late-2007. Manufacturing and services both saw slower rates of deterioration in June, talking the overall pace of decline to the slowest since May of last year. But the comparison is not completely accurate, as the Spanish index does not include construction (for which a PMI survey does not exist). However, with construction faring especially badly in Spain in the current downturn according to official data, this suggests that Spain's rate of contraction would be even steeper than that signalled by the PMIs, confirming Spain's position at the foot of the PMI growth table.

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