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Markit Economics Research

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UK economy

All-Sector UK PMI rises above 50.0 no-change level in May for first time in 14 months

- **A weighted combination of the output measures from the three UK PMI surveys rose above the critical no-change level of 50 in May.**
- **The rise means the UK is the first of the European economies to see a return to economic growth.**

Broad-based turning point, though only services has so far returned to growth

Strong improvements have been recorded in the three PMI surveys that are conducted by Markit in the UK in association with CIPS:

- Business activity in the construction sector – which has seen the steepest downturn since the start of the financial crisis – fell for the fifteenth successive month in May, but the rate of decline has now eased for three months in a row since hitting a record in February (with record increases in the index seen in April and May). May's rate of decline was the slowest since April of last year.
- Manufacturers, hit by the collapse in global trade, reported a fourteenth consecutive monthly fall in production in May. But they also saw a sharp easing in the rate of decline from February's peak, meaning the latest fall was the smallest for a year.
- Most encouragingly, the sharply slower rates of contraction in the construction and manufacturing sectors were accompanied by a return to growth of service sector activity, which rose in May for the first time since April of last year. The rate of contraction of services activity peaked in November of last year.

Combining the output measures from the three PMI surveys, using weights determined by their relative importance according to GDP data, shows that the resulting 'All-Sector' Output Index rose above the 50.0

Chart 1: All-Sector PMI Survey

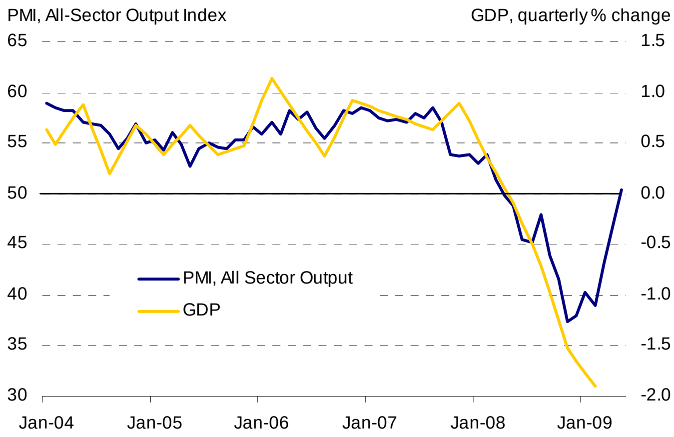


Chart 2: PMI Output by Sector

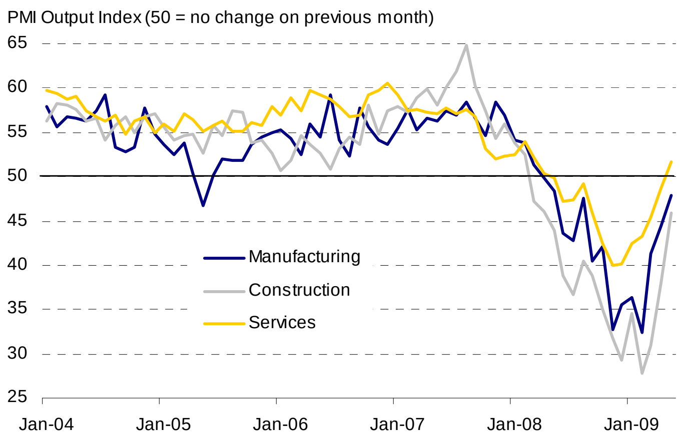
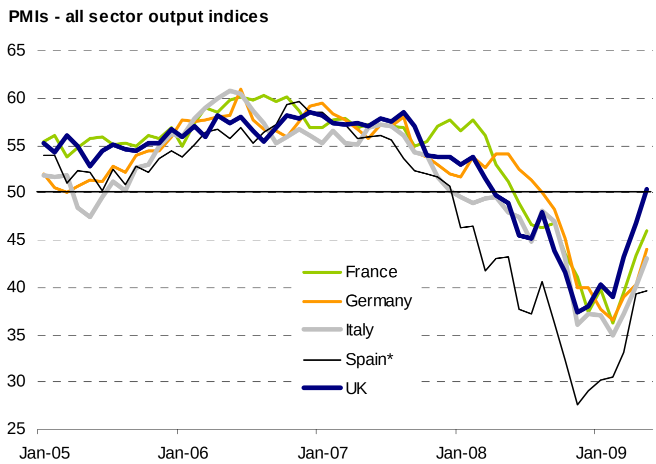


Chart 3: Country comparisons



** Spain excludes construction, included in all others.*

level – the cut-off between growth and contraction. Although only marginal (the index hit 50.4), this was the first time that any expansion has been recorded since March of last year.

GDP to rise in Q2?

The latest available Reuters poll of economists' forecasts, made in early May, indicated that UK GDP was expected to contract by 0.7% in Q2, following the 1.9% collapse seen in Q1, and then to fall by 0.3% in Q3. A return to growth was in fact not envisaged until the first quarter of 2010, as zero growth was anticipated for the final quarter of this year.

But the unexpectedly steep rise in the PMI data over the past three months raises the likelihood of an earlier than expected return to growth. The move of the All-Sector Output Index above the 50.0 mark would normally be consistent with a return to quarterly GDP growth, suggesting that – if sustained – the rise in the PMI surveys into June would indicate an increase in GDP as early as Q2 (albeit an extremely modest rise).

However, a heavy dose of caution is necessary here, as estimating the precise growth trend from GDP using business surveys has proven difficult in the two quarters that followed the collapse of Lehman Brothers. Both survey indices and GDP moved into unchartered territories at the height of the contraction, at least as far as modern data collection methods are concerned, and the surveys signalled a weaker rate of decline than official GDP in almost all countries, not just the UK. This either reveals some non-linearity in the PMI index numbers when moving to extreme levels away from the 50.0 no-change mark, or points to some major future revisions to initial GDP estimates (though most likely this is some combination of the two).

It seems plausible that, now the PMI indexes have moved back into 'normal' bounds, their relationship with GDP growth trends will have been restored. If so, the PMI surveys present a significant upside risk to the prevailing consensus forecasts.

UK recovers before its neighbours

The rise in the UK index above 50.0 is also notable because it has occurred at a time when comparable indices for other European countries remain firmly mired in contraction territory.

Compared to the UK's All-Sector Output Index reading of 50.4 in May, the next highest reading in Europe is 46.0, seen in France, followed by 44.1 in Germany and 42.6 in Italy. Spain continued to underperform with an All-Sector Output Index of 39.6, which is all the more worrying for Spain, as it is the only country listed here to exclude the particularly hard-hit construction sector.

Whereas the UK has seen a return to expansion in May, current trajectories (if sustained) imply that growth will not be seen until August for the Eurozone as a whole.

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