

# UK manufacturing

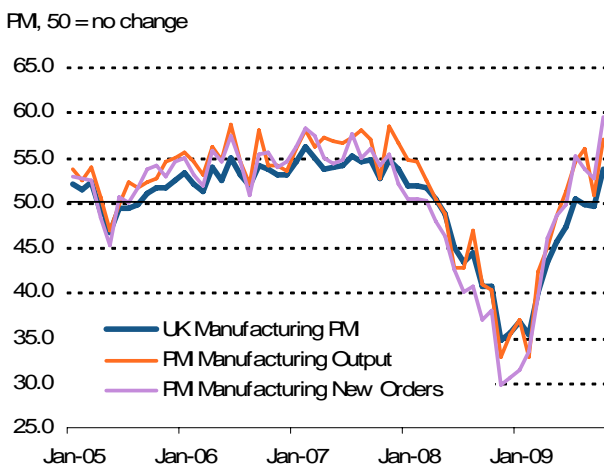
## Manufacturing entered Q4 on stronger-than-expected footing

- **October PMI well above market expectations...**
- **...reflecting a solid first step on the long and uncertain road to recovery.**
- **Re-emergence of price pressures may muddy the policy-making waters.**

The CIPS/Markit UK Manufacturing PMI rose to a 23-month high of 53.7 in October, well above analysts' expectations of 50.1 (according to a Thomson Reuters consensus poll). The PMI has been above the neutral 50.0 mark in three of the past four months.

Growth of output and new orders regained momentum in October, hitting 23- and 69-month highs respectively and signalling a robust start to the final quarter of 2009. Gains in both variables were recorded in the consumer and intermediate goods sectors and across SME's and large firms. However, the capital goods sector continued to see falling volumes of new orders and production.

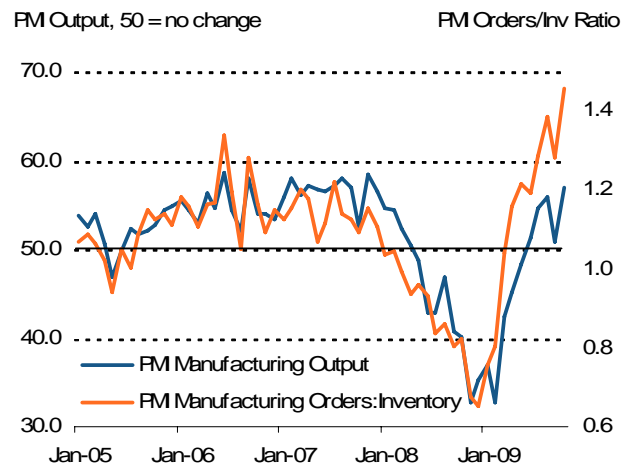
**Chart 1: PMI, Output and New Orders**



Reasons for continued caution should therefore now be balanced with growing signs of recovery. The new orders-to-stocks of finished goods inventory ratio from the PMI survey – which tends to move in advance of

manufacturing production – hit an 18-year survey high in October. The combination of a global recovery and the weak sterling exchange rate should also boost UK export performance in the coming months. PMI data signalled that price discounting was less prevalent in October, and companies reported that higher order intakes and a move towards restocking at clients encouraged them to restart production lines in some cases.

**Chart 2: PMI Output vs Orders/Inventory Ratio**



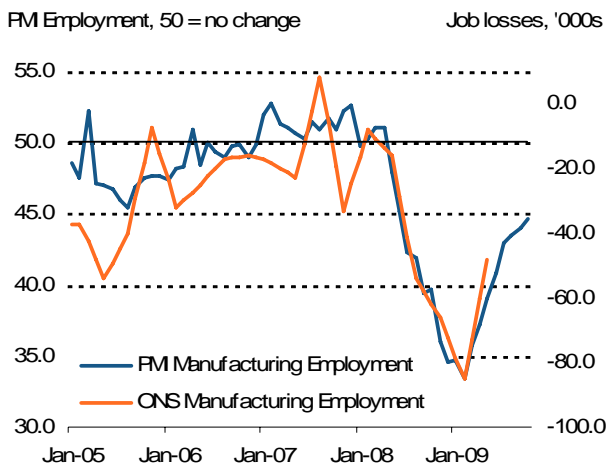
However, the improving trend signalled by the business surveys still needs to be viewed in the context of the deep recession that preceded it and ongoing weakness in official economic data. The latest manufacturing PMI reading points only to the first step on what looks likely to be a long and uncertain road to full recovery.

UK manufacturing production (according to the official ONS data) is at levels last seen in mid-1992, meaning that the gains in output achieved since the last UK recession have been reversed by the recent downturn. The picture in the labour market is even starker, with manufacturing employment lower than at any point since comparable records began in 1978.

Indeed, looking at the Employment Index from the CIPS/Markit survey in October indicates that the

downturn in UK manufacturing staffing levels has not yet run its full course. The rate of job losses eased to its weakest in 16 months, but remained rapid and much faster than the survey average. This translates into an easing in the pace of job losses of 85k in Q1 2009 (according to ONS data) to what is likely to be around 40k in Q3 and 35k in Q4 (based on the October PMI data only).

**Chart 3: Manufacturing employment**

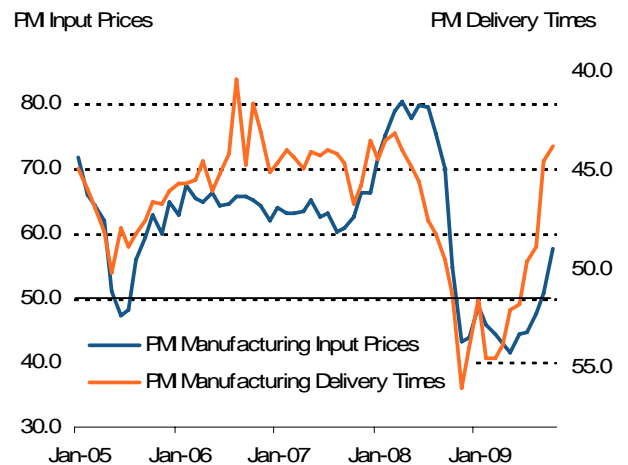


There is also the continued supportiveness of fiscal and monetary stimulus packages to consider, especially as the current accommodative environment cannot be sustained indefinitely.

Policy-making is likely to be complicated by signs that price pressures are re-emerging. The PMI Manufacturing Input Prices Index rose to a 13-month high in October, following further increases in the cost of commodities and the impact of the weak sterling

exchange rate on the price of imported inputs. The Suppliers' Delivery Times Index, a reliable barometer of supply-chain price pressures, indicated that vendor lead times lengthened to the greatest extent in over one-and-a-half years. If rising commodity prices spill over into the wider economy, any additional monetary support may have dangerous consequences later down the line.

**Chart 4: Rising price pressures**



The overall picture remains one of UK manufacturing emerging from its recession and that there are increasing signs that the rebound may be sustainable. However, this cautious optimism remains dependent on appropriate monetary and fiscal support continuing, which may become more difficult if inflationary pressures increase or broaden.

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