

UK economy

All-Sector UK PMI hits 18-month high; increases possibility of GDP growth in Q3

The weighted combination of the Output Indices from the three UK PMI surveys¹ that are conducted by Markit in association with CIPS indicated a continuation of growth of the private sector economy in August. Output rose for the fourth successive month and at the steepest pace since February 2008, with the 'All-Sector' Index reaching 53.7 (from 52.9 in the previous month).

- **Manufacturers** indicated the strongest rise in output of all sectors covered during August, with growth maintained for a third month running and at the fastest pace since December 2007.
- **Service sector** activity increased for a fourth successive month, with growth the sharpest for almost two years.
- The **construction sector** continued to experience falling activity in the latest survey period, although the rate of contraction was the slowest in 18 months.

In all three sectors, performances are considerably improved when compared to the end of 2008 and early 2009, when output/activity was contracting at unprecedented rates (see chart 2).

When assessed against official data, the 'All-Sector' Index is consistent with marginal GDP growth in the third quarter. At an average of 53.3 for Q3 so far (July and August data), the Index is on course to record its best performance since the final quarter of 2007, when official data showed that the economy expanded by 0.5% q/q.

Given the recent divergences between first estimates of GDP and the PMI, it remains wise to adopt a degree of caution when formulating an exact forecast for Q3 but, taken at face value, it would be somewhat surprising not to see economic growth recorded when the first estimate of Q3 GDP is released in late October.

Chart 1: All-Sector UK PMI

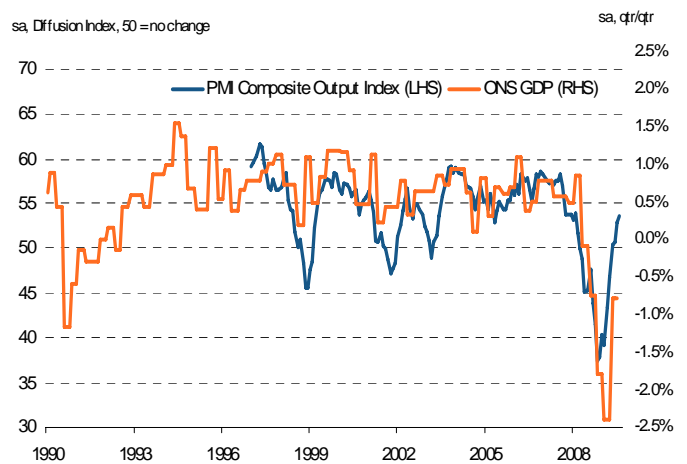
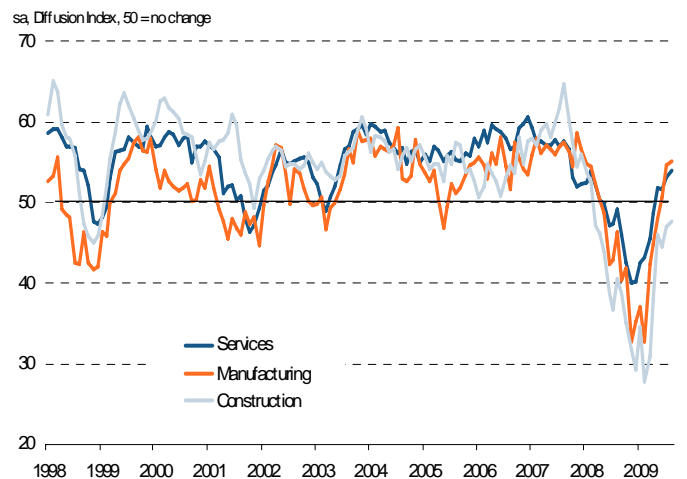


Chart 2: PMI Output by Sector



¹ Weights determined by each sector's relative contribution to the UK economy according to GDP data.

Slow and uneven growth ahead?

The improved business climate, and the growing sense that “we are over the worst” has played an important role in driving overall workloads higher in recent months. Expectations in the services economy have reached a two-year peak and confidence remains relatively high in construction. Moreover, the forward-looking orders-inventory ratio for manufacturing points to continued growth in production in the short-term at the very least.

However, the latest PMI data provide some evidence that is consistent with the view of a period of subdued and uneven economic expansion. Growth in both manufacturing and service sectors in August was not solely driven by gains in new business, but also reflected the running down of backlogs of work. Moreover, sales were commonly driven by continued price discounting in both sectors amid reports (particularly amongst service providers) that the economic climate remained fragile and the marketplace extremely competitive.

Job losses set to ease further in coming months

A key downside risk to future growth remains rising unemployment which, according to the latest ONS data, rose by 220,000 in the three months to May to an overall level of 2.43 million. Further falls in employment look likely: the All-Sector Employment Index remained well below the crucial 50.0 no-change mark in August, signalling a net fall in private sector employment for a sixteenth successive month as companies continued to reduce capacity.

Although the rate of job losses remained historically steep, there are some tentative grounds for optimism. August’s contraction was the lowest for nearly a year, and was the fourth time in the past five months in which staffing levels have declined at a slower pace. This suggests a clear turning point in the employment cycle, with the largest falls in jobs now behind us (see chart 3).

Moreover, the All-Sector PMI index has reached a level that is historically consistent with stable employment (see chart 4). Assuming output growth can be at least maintained at its current level, then the PMI data suggest the private sector job market could be close to stabilisation by the end of this year.

Chart 3: All-Sector PMI Employment Index

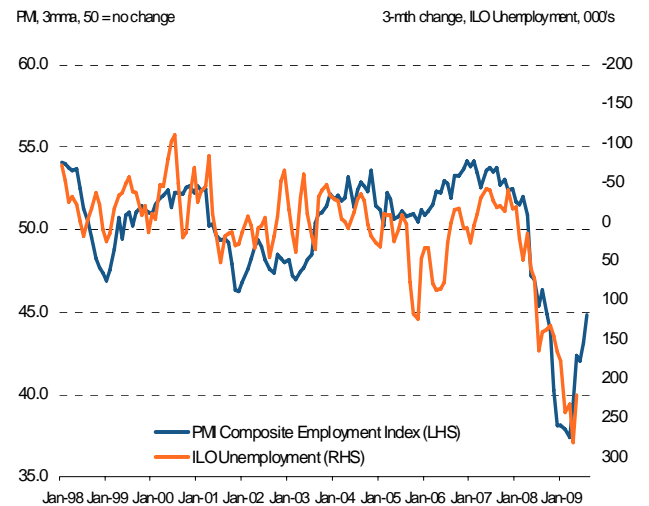
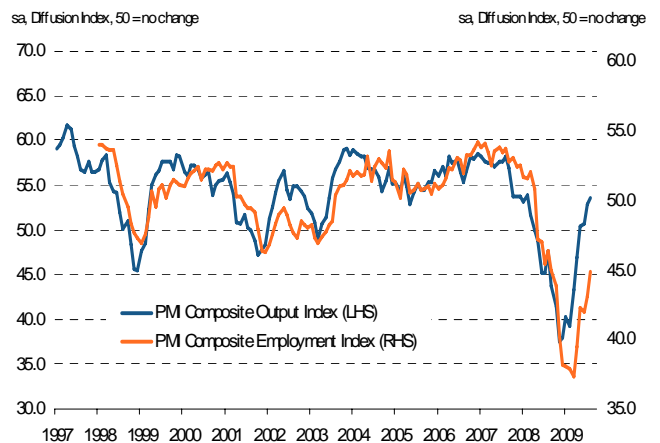


Chart 4: All-Sector PMI & All-Sector Employment



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