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Markit Economic Research

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UK economy

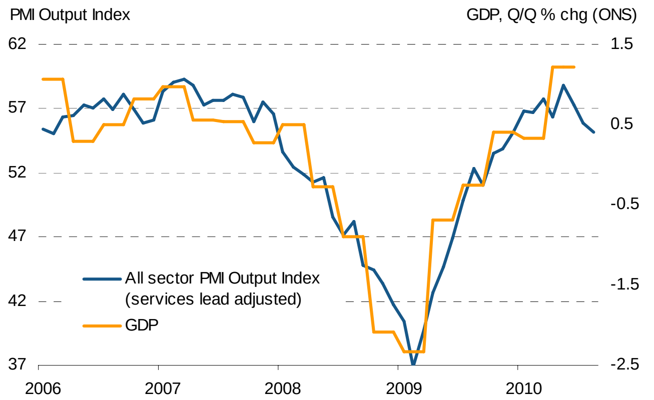
Growth slows sharply in Q3 with risk of further slowdown ahead

The weighted average of the output indices from the three UK PMI surveys fell further in August from February's post-recession peak, dropping 1.8 points – the largest decline since November 2008. The increase in output signalled in August was the weakest since June 2009.

At 53.2, the average all-sector PMI Output Index reading for the first two months of Q3 is well below the average of 56.5 seen in the first half of the year. Our model based on PMI data up to August is signalling a GDP increase of 0.5% for Q3. A lower figure could be possible if the PMI output indices fall further in September, which seems likely given the recent trends in new orders, employment and business confidence.

The latest data therefore indicate that the second quarter surge in gross domestic product most likely represents a distinct peak in the recovery cycle. GDP data showed the economy expanding 1.2% in Q2, the largest quarterly increase since 2001 and up sharply from 0.3% in Q1[1].

GDP v. PMI

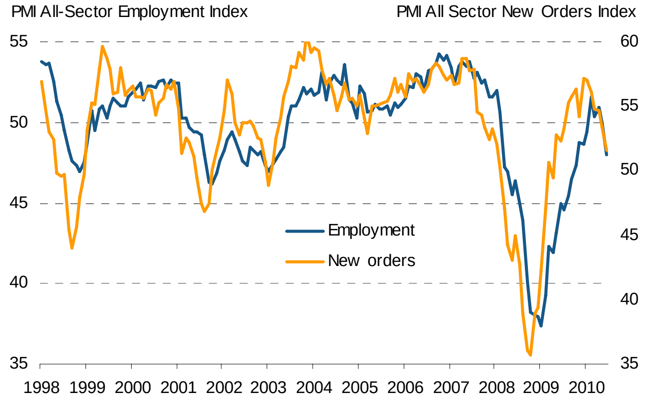


[1] The rapid acceleration in GDP growth between Q1 and Q2 can in part be attributed to disruptions to business, such as adverse weather hitting construction projects, which subdued growth in Q1 but boosted activity in Q2. We believe many PMI survey respondents may have made an allowance for such disruptions, meaning the PMI trend has been smoother than GDP over the first half of the year.

Weak orders point to slower growth ahead

New orders – a key driver of output – grew in August at the slowest rate in 14 months, measured across all three sectors covered by the PMIs. The rate of growth has eased continually since peaking in February. A near-stagnation of new business inflows was seen in services, while growth of new orders weakened to only modest rates in both construction and manufacturing, the latter suffering in particular from weaker growth of demand for consumer goods.

Employment and new orders



Employers cut headcounts again

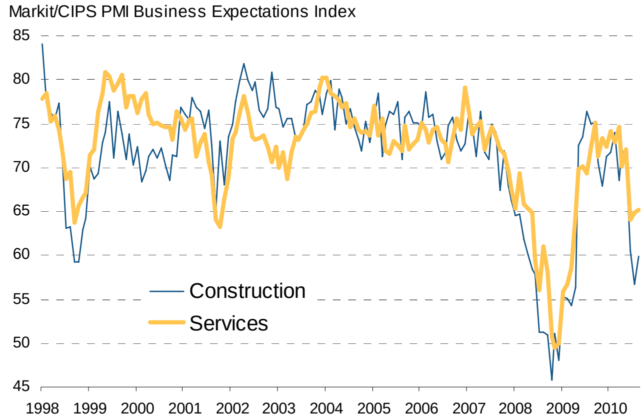
The labour market is already showing signs of turning down again in response to the weaker inflows of new business. This raises the risk of a further drop in consumer spending as unemployment and job insecurities rise. The PMI surveys indicate that, having increased in the three months to June, private sector employment fell for the second month running August, with the rate of job losses accelerating to the steepest since December.

Job losses were most widespread in the service sector, followed by construction. Manufacturers continued to take on new staff, but at the slowest rate in the past five months.

Confidence signals risk of renewed downturn

The deterioration in the labour market is unsurprising given the extent to which confidence for the year ahead has fallen in recent months. Having suffered record falls in response to the public sector spending cuts and VAT rise announced in June's emergency Budget, the PMI Expectations Indices for construction and services (this index is not available for manufacturing) have since failed to pick up appreciably.

Expectations about activity in 12 months' time

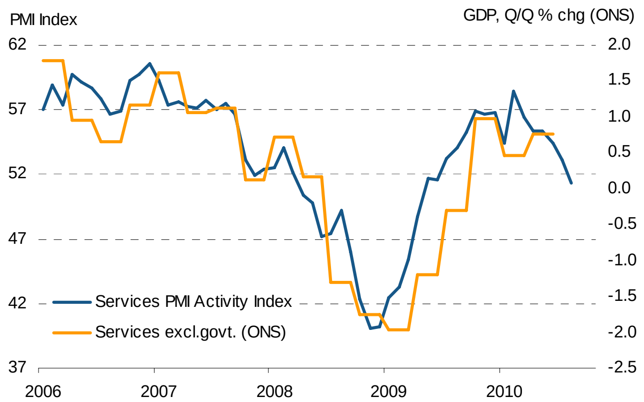


Although pessimism is less rife that at the height of the financial crisis, confidence in both sectors is very low by historical standards and consistent with a renewed contraction of activity, therefore suggesting the increased risk of a slide back into recession.

Across-the-board weakening

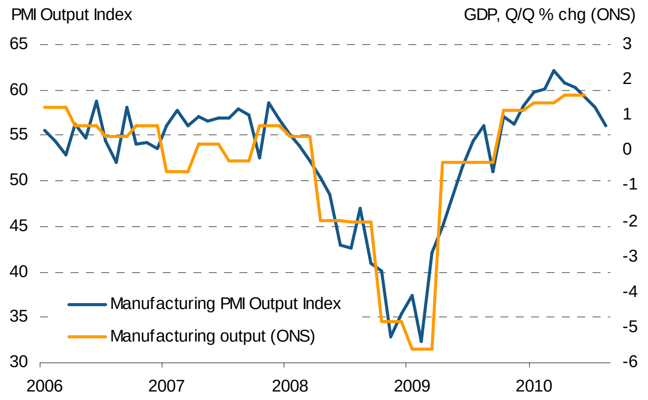
The PMIs have signalled a weakening of growth across the board in recent months. Most significant is the slowdown in the service sector, where the Activity Index hit a 16-month low in August. The data are roughly consistent with service sector GDP growth (excluding government services) sliding from 0.8% in Q2 to approximately 0.2%–0.3% in Q3 so far.

Services



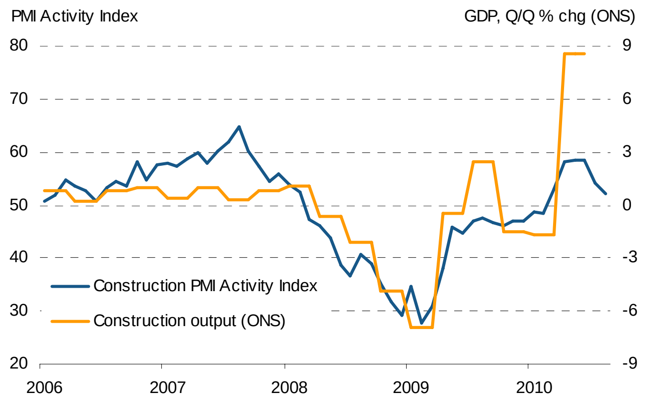
Manufacturing provided a substantial boost to GDP in Q2, expanding 1.6% to post its strongest performance since mid-1999. Such strong growth had been predicted by the manufacturing PMI's Output Index, which hit a fifteen-and-a-half year high in March. But the index has since fallen considerably, hitting an 11-month low in August and suggesting a sub-1% expansion in Q3.

Manufacturing



The construction sector also looks set to show substantially weaker growth in Q3 compared to the massive 8.5% jump in output signalled by the recently revised GDP data for Q2. The PMI survey has meanwhile now signalled rising construction sector activity for six successive months, but the rate of growth peaked in May and slowed sharply in both July and August to register the weakest growth so far in the recovery. However, while the PMI data have provided a good indication of the underlying growth trend in the construction sector, they have often failed to pick up quarter-to-quarter variations, so precise implications for the sector's contribution to GDP are difficult (see footnote on page 1).

Construction



Sources for all charts: Markit, ONS

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