PMI Data Points To Healthy Growth In Q3

Wednesday 4 September, 2013

Activity in the UK services sector grew at its fastest rate since December 2006 in August, according to the latest figures from Markit and the Chartered Institute of Purchasing and Supply (CIPS). The headline Purchasing Managers' Index (PMI) for the sector stood at 60.5 in August, up from 60.2 in July. PMI data indicate that the UK service sector has grown in every month of 2013 to date and has accelerated with each passing month.

The service sector PMI outperformed consensus expectation of 59.0 with growth largely driven by the strongest expansion in new businesses for 16 years. The rise in new business was buoyed by strengthening market confidence which looks set to increase as half of survey respondents expected activity to rise further in the coming months. Firms also reported an improvement in market demand, in line with growing business confidence. In addition, backlogs rose at their sharpest rate since February 2000, putting pressure on capacity due to insufficient employee numbers. Despite this, growth in the employment index weakened significantly dropping from 53.6 in July to 50.6 in August, bucking the recent trend of faster headcount growth. As the largest sector of the UK economy, solid growth in services bodes well for the recovery which looks set to strengthen in Q3.

Construction has now risen for four consecutive months and in August the PMI for the sector rose to 59.7, up from 57.0 in July; its fastest pace of growth since September 2007. New residential buildings were once more the strongest performing area; higher levels of housing activity have now been recorded for seven successive months. The marked rise in civil engineering activity is an emerging positive trend as it continues last month's expansion in an area which contracted throughout Q1 and Q2 2013.

Manufacturing, too, has shown resolute growth in recent months and in August the PMI rose from 54.8 to 57.2; its highest level for two-and-a-half years. Moreover, output and new order growth rates reached their highest points since 1994, supported by a reported increase in export demand from the USA, China and crucially the UK's main export partner, the Eurozone. However, this was not reflected in the employment index which maintained growth but at a slower rate than July, as companies looked to maximise the output of existing staff. In addition the marked rise in the price of inputs led to the highest cost inflation growth in two years.

The strong growth in all three sectors is of undoubted benefit to the economy and may put pressure on Bank of England Governor Mark Carney's pledge to keep interest rates at their record low level until unemployment falls below 7%. This is not predicted to occur until 2016 but markets believe that sustained growth may force the central bank's hand before this is the case. As noted by the Governor of the Bank of England, UK employee productivity is no higher than in 2005, so firms have plenty of scope to increase output by making existing employees more productive as opposed to hiring new workers. This could serve to keep unemployment elevated even as the economy recovers - so market expectations that interest rates will rise before 2016 may be unwarranted.

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