Markit Economic Research
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United Kingdom

Robust December PMIs end solid fourth quarter, but optimism nears three-year low

- **'All-sector' PMI points to 0.5% Q4 GDP growth**
- **Rate of job creation slows further**
- **Growth driven by services**

The UK economy looks to have expanded by 0.5% in the final quarter of last year, according to PMI business survey data. Sustained robust growth of activity and order books in December suggests the economy is starting 2016 with reasonable growth momentum, though there are signs that the recovery remains worryingly unbalanced and that business confidence is waning.

Surveys signal 0.5% GDP rise in Q4

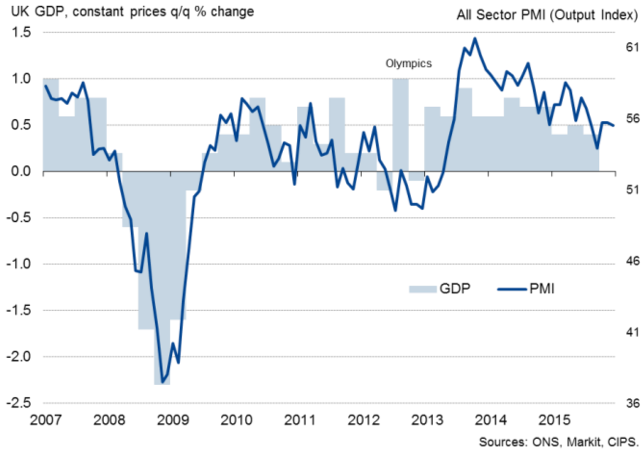
At 55.5, the weighted average of the output indices from the three UK PMI surveys fell from 55.7 in the prior two months but remained well above the 50.0 no-change level to signal yet another month of robust economic growth. The average 'all-sector' PMI reading of 55.6 seen over the course of the fourth quarter is broadly consistent with gross domestic product having risen by 0.5%, meaning the economy would have expanded by 2.2% in 2015.

Growth in December was once again primarily fuelled by the vast service sector, where the PMI data point to a 0.5% expansion of output in the fourth quarter despite a slight loss of momentum between November and December. The fastest growth in the fourth quarter was seen in financial services and transport services.

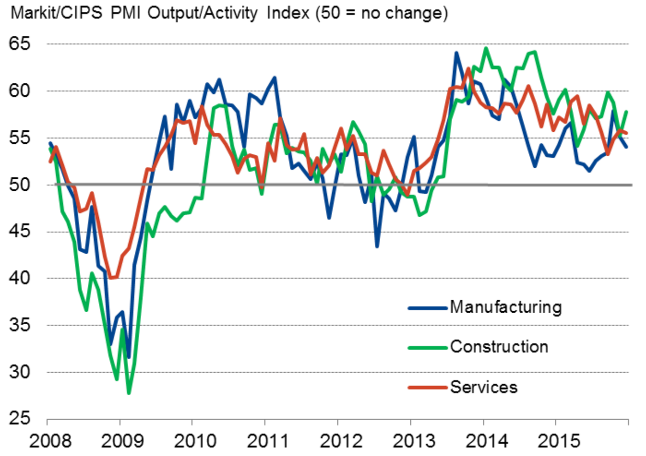
However, while services provided the main impetus behind the ongoing upturn due to its sheer size, it was the far smaller construction sector which recorded the fastest rate of growth of the three main parts covered by the surveys, with the PMI reviving from November's seven-month low. Faster growth of house building and commercial construction offset a renewed decline in civil engineering activity.

The solid pace of expansion signalled by the survey throughout last year suggests that builders are faring better than indicated by recent weak official construction data (which showed output falling 1.9% in

UK PMI and GDP compared

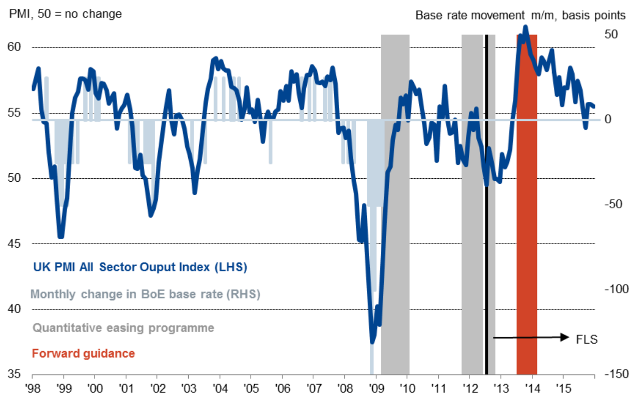


Business activity by sector



Source: Markit.

Bank of England policy decisions and the PMI



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the third quarter, a factor contributing to the relatively weak 0.4% GDP rise).

The weak link in the economy therefore remained the manufacturing sector, where the PMI output index has fallen to a level consistent with a near stagnation of factory production. Producers reported the joint-weakest rise in new orders since September 2014, linked in part to a deterioration in export growth and the strength of sterling.

Rate of job creation cools

The rate of growth in employment signalled by the survey in December was the joint-slowest recorded since September 2013. Although construction sector hiring continued to boom, service sector employment showed the smallest rise for five months and factory headcounts rose only modestly.

While manufacturers remain worried about the need to cut costs in the face of sterling's rise and weak demand, the reduced rate of services hiring can be traced to a broader waning of business optimism: expectations about future workloads in the service sector fell to the lowest seen for almost three years.

Costs rise at increased rate

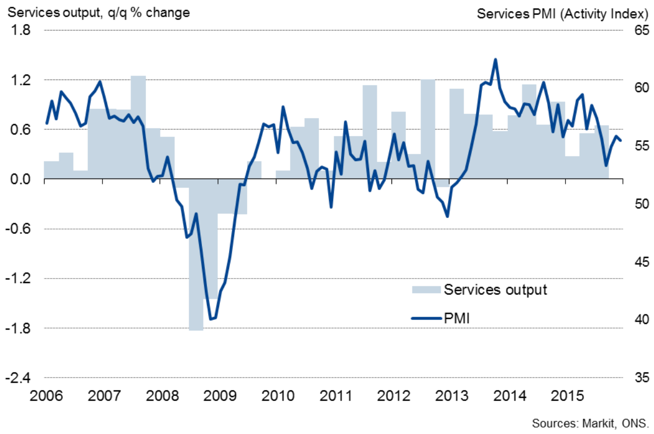
A modest uplift in price pressures was evident from the December survey results. Input costs across the three sectors rose at the fastest rate for five months, despite falling commodity prices pushing manufacturing costs down sharply again. Average prices charged for goods and services rose only marginally, albeit registering the largest increase since September.

Policy stasis

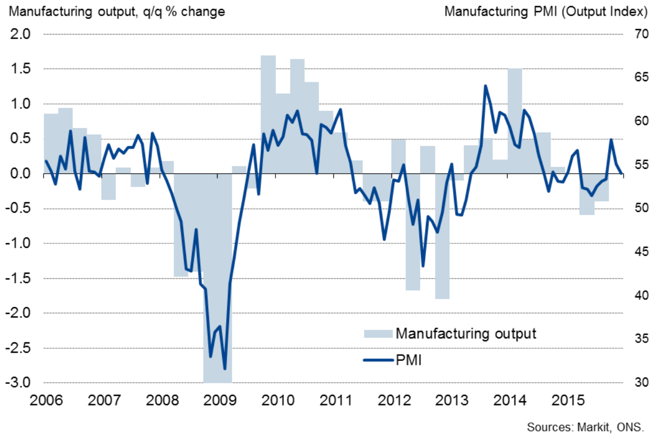
The 'all-sector' PMI remains in territory that would normally be associated with a possible tightening of monetary policy (see chart), but only by a small margin. With the Bank of England projecting only a slow rise in inflation over the course of the next two years, wage growth subsiding again according to the latest official data and the PMI surveys showing the economy to have lost growth momentum in the second half of 2015 compared to the first half of the year, it seems unlikely that the UK will see a rise in interest rates in the first half of 2016.

However, where policymakers will be concerned is in the source of growth, and notably the rise of credit. Bank of England data showed the largest (£1.5bn) increase in consumer borrowing seen since prior to the global financial crisis in November, with debt growing at an annual rate of 8%. With the household savings rate also down to a near-record low, increasing numbers of policymakers may soon start to feel the need to raise borrowing costs.

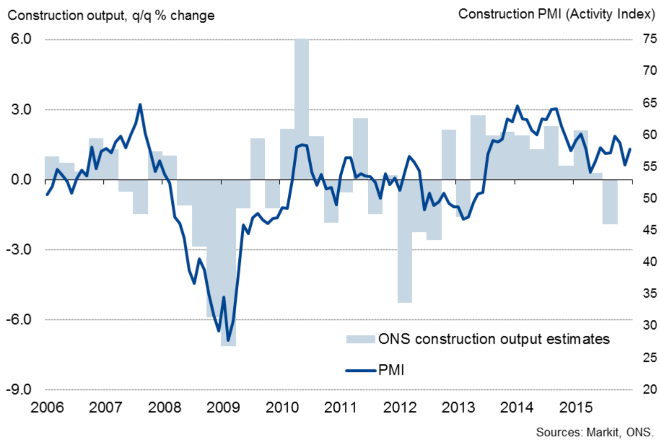
UK services: official and survey data compared



UK manufacturing: official and survey data compared



UK construction: official and survey data compared



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