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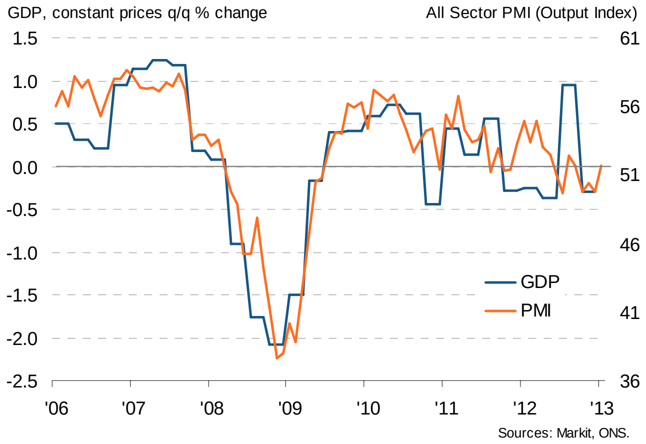
United Kingdom

PMIs signal economy's return to growth in January

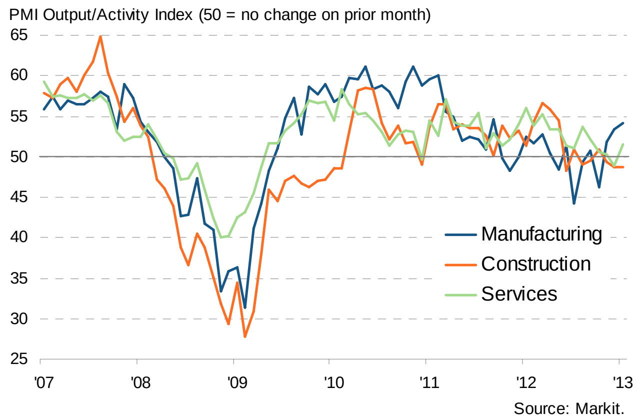
- **All sector PMI rises to four-month high in January, pointing to reduced risk of recession**
- **Faster growth in manufacturing accompanied by return to growth of services**

Business activity picked up at the start of the year, according to the PMI surveys, pointing to a return to growth of the UK economy and greatly reducing the likelihood of the country falling back into a "triple-dip" recession. The all-sector Output Index from the three PMI surveys rose from 49.8 in December to 51.7 in January, signaling the strongest pace of expansion for four months. Historical comparisons with GDP suggest that a PMI reading of this level is consistent with the economy expanding at a quarterly pace of 0.1%.

GDP and the PMI



Sector output trends compared



January saw the largest monthly increase in service sector activity since September, adding to the promising news from manufacturers last week, where output was reported to have grown in January at the fastest rate for 16 months. Although construction continued to contract, the downturn in the building sector is dwarfed by the improvements seen in the far larger services and manufacturing sectors.

Snow-impact assessment

Stronger growth would inevitably have been recorded across the three sectors in January had the country not suffered heavy snowfall in the second half of the month. However, the anecdotal evidence from survey contributors suggests that the overall impact of the snow was quite modest, depressing the all-sector output index by around one index point. Taking the estimated impact of the snow into account, a resulting PMI reading of 52.7 would have signalled the strongest monthly increase in output since last April, consistent with GDP rising at a quarterly rate of approximately 0.2%.

Reduced triple-dip recession risk

The forward-looking indicators also bode well for growth in coming months. New business at the all-sector level rose for the first time in three months in January, growing at the fastest rate since September. The upturn in new business was led by the service sector, though manufacturers also saw a modest increase in new orders and construction companies saw a marked easing in the rate of decline.

The upturn in new business, plus growing numbers of enquiries from customers, helped push business confidence to an eight-month high in services and a six-month peak in construction. Confidence has also been buoyed by signs of stronger global economic growth in recent weeks, the easing of concerns over the eurozone crisis and US fiscal cliff, and rising stock markets.

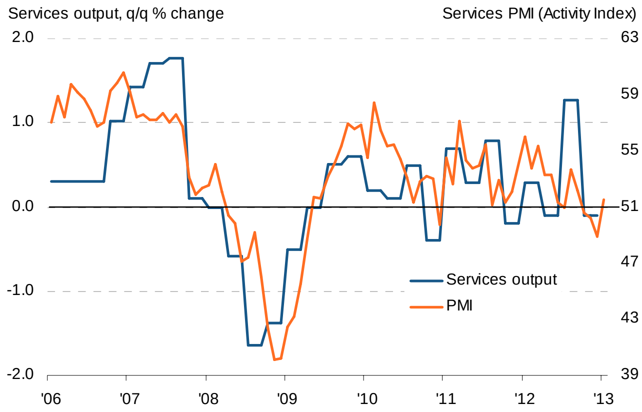
The January PMIs therefore provide reassuring evidence that the UK economy could return to growth in the first quarter. Official data had shown that the economy contracted by 0.3% in the final quarter of last year, meaning a second consecutive quarterly decline in the first quarter of 2013 would constitute the UK sliding back into recession for the third time since 2008. However, with only modest growth signalled by the PMIs, the economy looks likely to merely regain the output that was lost in the final quarter of last year.

Services revive from weak fourth quarter

The January upturn was largely attributable to a return to growth of the service sector which, as covered by the PMI, accounts for 42% of GDP. By comparisons, manufacturing accounts for just 12% and construction only 7%. Having slid to a near four-year low of 48.9 in December, the Business Activity Index from the Services PMI rose to a four-month high of 51.5 in January.

Official data had shown the service sector contracting by 0.1% in the final quarter of last year, which was broadly in line with the signal from the PMI (which averaged 49.9 in the final three months of 2012). The upturn in the PMI therefore suggests that the sector saw a return to modest expansion at the start of the first quarter.

Services



Sources: Markit, ONS.

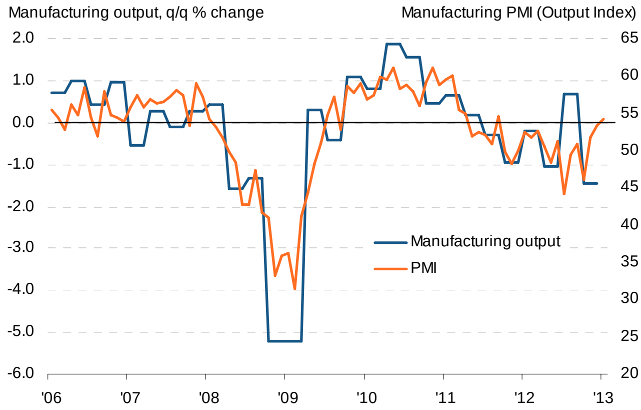
Manufacturing growth strengthens

Stronger growth in manufacturing also contributed to the rise in the all-sector PMI in January. The headline manufacturing PMI signalled an overall improvement in business conditions for the second month running, fuelled by the strongest monthly increase in output for 16 months. The Output Index from the survey jumped from 53.4 in December to 54.2.

Official data indicated that the goods-producing sector's output slumped 1.4% in the final quarter of last year, its steepest decline since the first quarter of 2009.

The official data were very volatile last year, due to the Jubilee public holidays, but the PMI suggests that the sector is on course to deliver a positive contribution to the economy in the first quarter.

Manufacturing

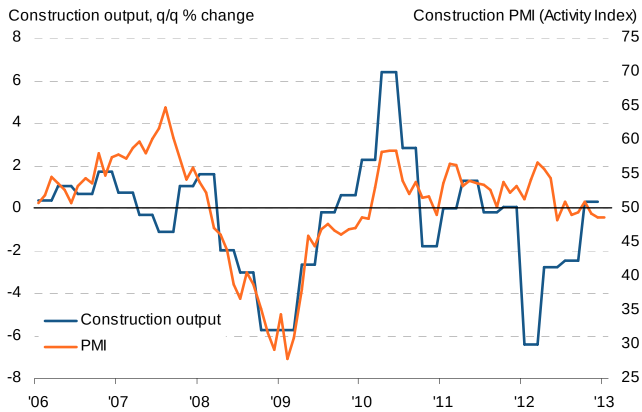


Sources: Markit, ONS.

Construction acts as drag

Construction industry output fell slightly in January, contracting at the same rate as December. The PMI activity index held steady at 48.7. The current rate of contraction is one of the steepest since early 2010.

Construction



Sources: Markit, ONS.

Construction bucked the downward trend seen in the wider economy late last year, growing by 0.3% in the fourth quarter according to the official data. If we assume that the strong divergence between official data and the PMI seen throughout much of last year has ended, the PMI suggests that construction could act as a mild drag on the economy again in the first quarter.

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