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United Kingdom

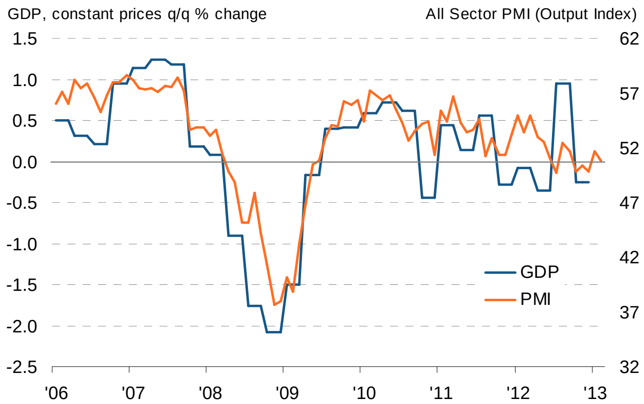
Services PMI upturn puts economy on course for marginal growth in first quarter

- **All sector PMI dips from January's five-month high but remains in expansion territory**
- **Service sector resilience offsets manufacturing and construction downturns**
- **Data ease triple-dip fears, but underlying picture is one of weak and hesitant upturn**

Worries about a triple-dip recession in the UK have been softened as service sector companies reported the strongest upturn in business activity for five months in February. The faster growth of the dominant services sector offset downturns in the far smaller manufacturing and construction sectors during February, meaning the economy is likely to have grown for a second successive month after the downturn late last year.

However, so far the PMIs suggest that the economy will have grown by 0.1% in the first quarter, barely making up for any of the 0.3% decline seen in the final quarter of last year. Given the marginal growth, the direction of the surveys in March will therefore prove decisive in determining whether the country avoided a slide back into recession. Encouragingly, many factors suggest that the performance of the business sector will improve in March and therefore avoid a further downturn.

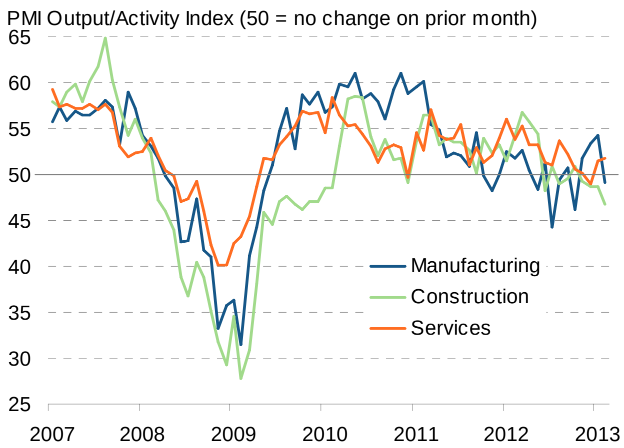
GDP and the PMI



Sources: Markit, ONS.

The all-sector Output Index from the three PMI surveys slipped from January's five-month high of 51.7 to 50.8 in February, but importantly held above the 50.0 no-change level to signal a second successive month of growth. 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%.

Sector output trends compared



Service sector growth accelerated to the fastest since last September, indicating that the slight decline in activity in December was merely a temporary soft-patch. Over the first quarter so far, the services economy looks to be on course to rebound from the 0.1% decline seen in the fourth quarter, though to merely notch-up a quarterly expansion of approximately 0.2%.

In contrast to the service sector upturn, manufacturing output fell for the first time in four months in February. Although the decline comes on the back of strong growth in January, the performance of the manufacturing PMI survey over the first quarter to date suggests that the sector looks set to contract by approximately 0.3%. The decline signalled so far nevertheless represents a big improvement on the 1.3% fall in output which the goods-producing sector saw in the fourth quarter of last year.

It was the construction sector, however, which reported the steepest downturn, with both commercial activity and civil engineering dropping sharply. Despite a small uptick in house building, the industry reported its fourth successive monthly decline, with the rate of contraction hitting the fastest since October 2009.

‘Triple-dip’ recession not averted for sure

Given the marginal growth signalled by the PMIs in the first two months of the quarter, March’s data will prove important in determining whether or not the country avoids a slide back into a ‘triple-dip’ recession. A modest set-back in the service sector alone would be enough to push the PMIs to a level consistent with a further fall in the GDP, suggesting that the economy would have therefore contracted for a second successive quarter, meeting the widely-used definition of recession.

However, there are good reasons why growth in March could turn out stronger than was seen in February. First, service sector confidence about the year ahead lifted to its highest since last May, and inflows of new business rose at the fastest rate since May. Such improvements tend to be precursors of higher activity in the following months.

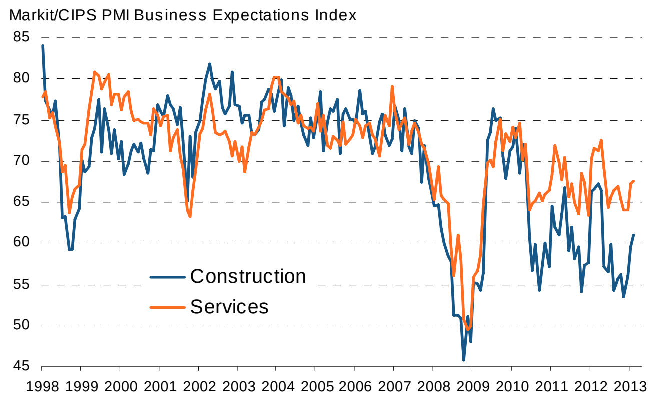
Encouragingly, business confidence in the construction sector also improved, rising to the highest since last April, and the sector continued to take on more staff, which suggests activity will rebound.

Finally, at least some of the weakness in manufacturing and construction in February was due to business being disrupted by bad weather, meaning a brighter picture may emerge in March. Heavy snow across parts of the country in late January will have had a knock-on effect in early February.

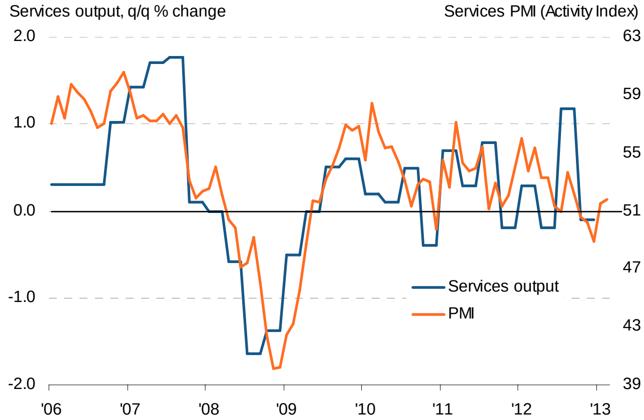
However, it is clear that the bad weather alone was not to blame for the weakness, and that underlying demand remains fragile, hit in the case of manufacturing by weak growth in export markets and in the case of construction by government infrastructure spending cuts and a lack of business investment.

While the UK may have avoided a triple-dip recession, the underlying picture is one of a modest and hesitant upturn.

Business confidence

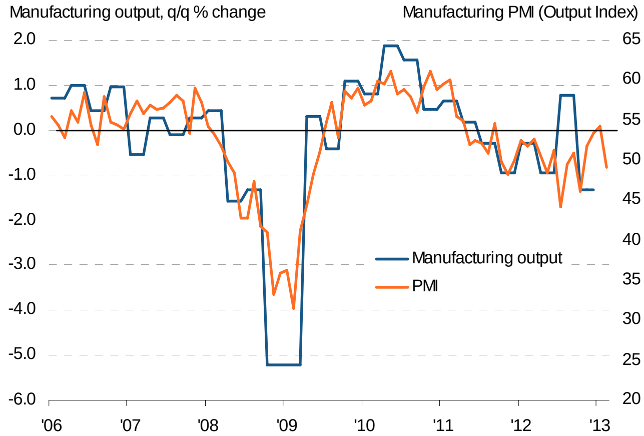


Services



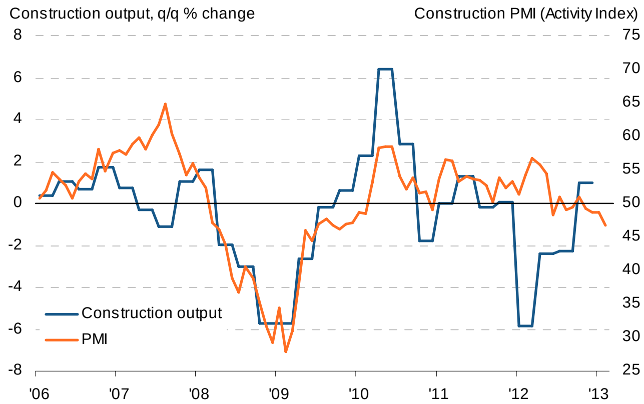
Sources: Markit, ONS.

Manufacturing



Sources: Markit, ONS.

Construction



Sources: Markit, ONS.

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