Markit Economic Research

04/06/2014

United Kingdom

Job creation sustained at all-time high as economy continues to surge

- **All-sector PMI dips in May but remains elevated, consistent with 0.8% GDP rise in Q2**
- **Employment growth sustained at record high**
- **Price pressures remain subdued**

Strong PMI surveys for May add further to signs of another strong expansion of the UK economy in the second quarter, with the latest growth spurt again accompanied by record job creation.

With every strong PMI reading, the more lively the discussion will become among the Bank of England's Monetary Policy Committee that a pre-emptive early hike in interest rates is warranted. However, with inflationary pressures remaining subdued, the case for higher rates is by no means clear cut.

At 59.1, down from 59.4 in April, the 'all sector' output index from the three Markit/CIPS PMI™ surveys collectively signalled a continuation of the strongest spell of private sector business activity growth seen in the 16-years of data collection, despite the pace easing slightly in May.

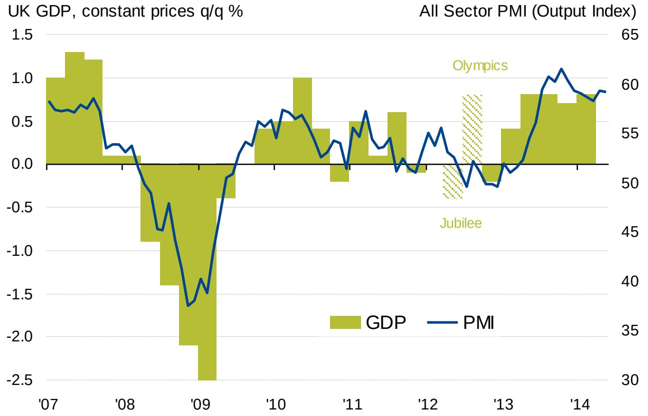
The PMI readings for the second quarter so far point to gross domestic product expanding by 0.8% in the second quarter, identical to the increase seen in the first quarter. If borne out by official data, which will be published in late-July, the GDP increase would at last lift the economy above its pre-crisis peak, attained in the second quarter of 2008.

Especially encouraging is the broad-based nature of the upturn, with PMI output indices for manufacturing, services and construction all at very elevated levels by historical standards. With new orders continuing to grow at a rapid pace in all three sectors in May, there is also little sign of momentum being lost.

Record employment growth

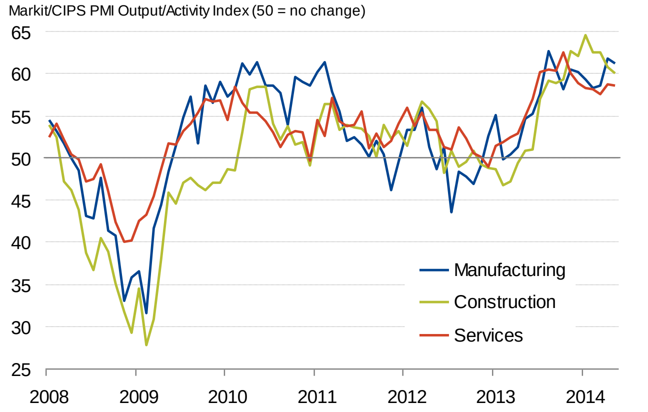
The PMI surveys also showed ongoing record private sector hiring in May, with the rate of increase unchanged on the 17-year all-time high seen in April. The 'all sector' Employment Index is roughly consistent with private sector employment growing at a rate of

UK economic growth and the all-sector PMI



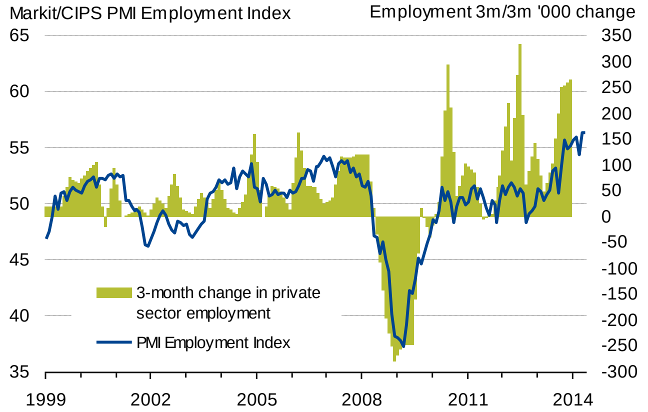
Sources: ONS, Markit.

Output/business activity indicators



Sources: Markit/CIPS.

Employment



170,000 per quarter. However, official employment data data are likely to show a stronger rate of job creation than the surveys, as has been the case throughout much of the post-crisis period, most likely reflecting changes to the welfare benefit system and austerity-related benefit clampdowns.

The strongest rate of job creation was seen in the construction industry, followed by services. Although still robust, employment growth in manufacturing was tempered by the desire to boost productivity.

'March of the makers'

Of the three sectors, manufacturing saw the highest PMI Output Index for the second successive month. Although the rate of increase slowed very slightly, it remained close to an all-time high and indicative of the sector expanding by approximately 1.5% in the second quarter. This would be the best performance the goods-producing sector has seen since the initial rebound from the financial crisis in the second quarter of 2010 and builds on the strong 1.4% rise seen in the first quarter.

The sustained strength of the manufacturing survey since the start of last summer points to the best protracted spell of growth the sector has seen in at least two decades.

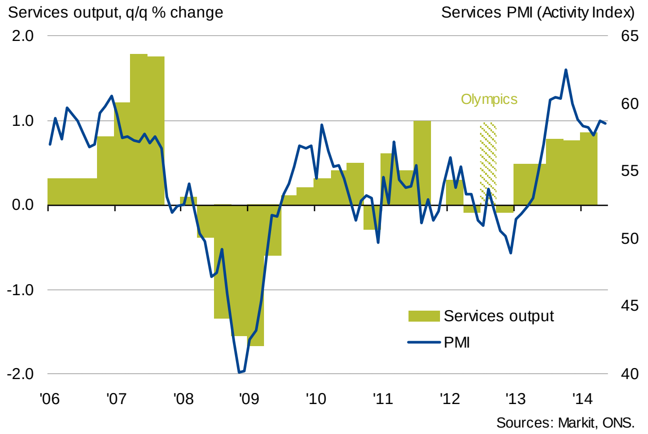
Building boom

Construction also continued to boom in May. Despite the rate of expansion moderating for a fourth straight month, the survey is running at a level consistent with the sector expanding by 3%. The survey data paint a much rosier picture of the construction sector than official data, which showed a 0.2% contraction in the fourth quarter and a mere 0.6% rise in the first quarter. In contrast, the PMI survey has been signalling a continuous boom in building activity since last summer.

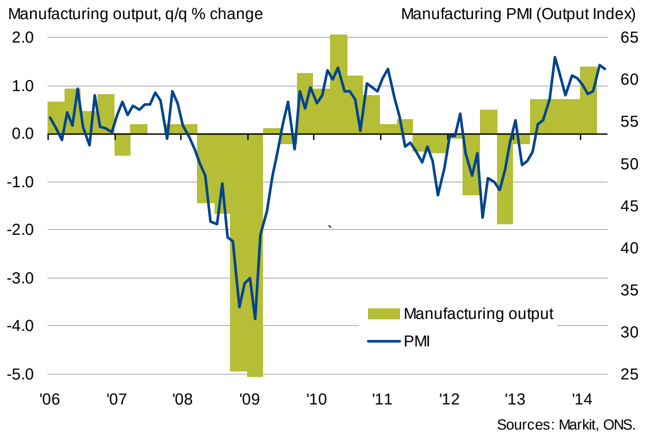
Service sector upsurge

It is the sustained solid growth in the service sector, however, which – due to its sheer size – has the most important implication for the economy's performance. Private sector services account for around one-third of GDP compared to 12% for manufacturing and just 7% for construction. The PMI survey showed that growth of services activity edged marginally lower in May but, like construction, the sector has been on a continuous growth spurt since last summer and pace of expansion remained well above its long term trend in May. The

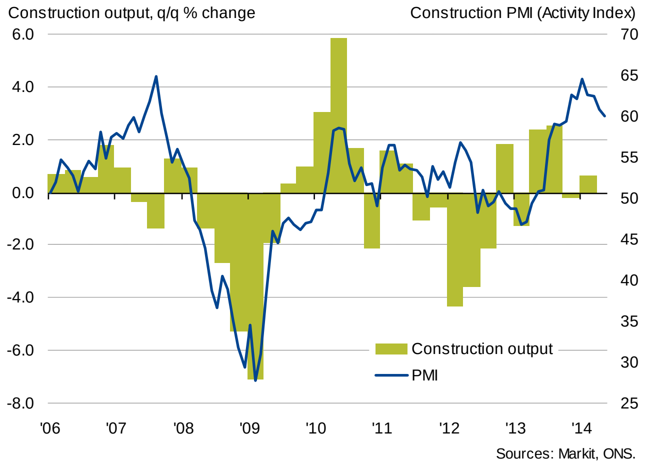
Services



Manufacturing



Construction



survey data are pointing to a 1.0% expansion of the sector following the 0.9% rise seen in the first quarter.

Twitchy trigger fingers at the BoE

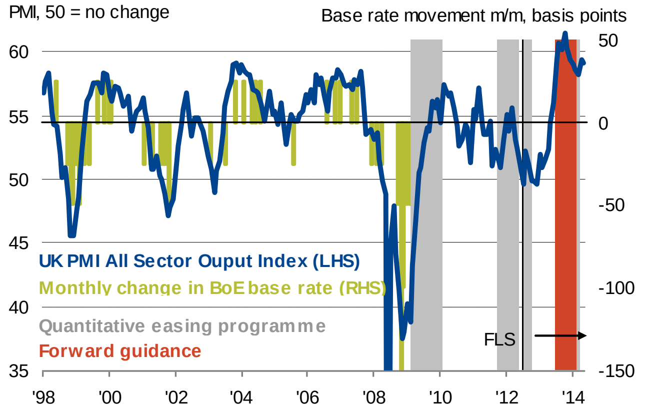
Since last summer the PMI has been in territory that in normal times would have been consistent with the Bank of England tightening monetary policy in order to cool the economy and ward off the threat of inflation. Rate rises have been resisted to date on the basis that there is an estimated 1-1.5% of GDP of slack in the economy, which would need to be used up before inflation might start to rise.

However, economic slack is notoriously hard to quantify, and the pace of growth of the UK economy and the speed with which jobs are being created will no doubt add to the belief among some Monetary Policy Committee members that an initial rate hike before the current projection of spring 2015 is warranted.

On the other hand, other policymakers will note that price pressures remain subdued. The latest PMI survey data showed limited upward pressure on prices through capacity constraint issues: manufacturing suppliers' delivery times lengthened, but not to a worrying degree. Backlogs of work meanwhile rose, but also not to a degree that typically causes prices to rise via demand outstripping supply. There was some upward creep in input cost pressures, and prices charged rose in May, but both measures remain below their long run averages.

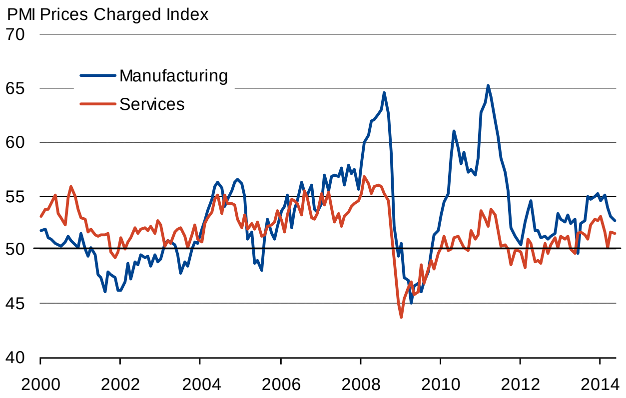
The doves among the Bank of England's policymakers' will also focus on still-muted wage pressures and sterling's appreciation since the start of the year, which will keep the lid on inflation and allow policy to remain loose, at least until wage pressures start to mount. Regular wages (excluding bonuses) are currently growing at an annual rate of just 1.3%, while inflation is 1.8%.

Bank of England policy changes and the PMI



Sources: Markit/CIPS, ONS.

Prices charged



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