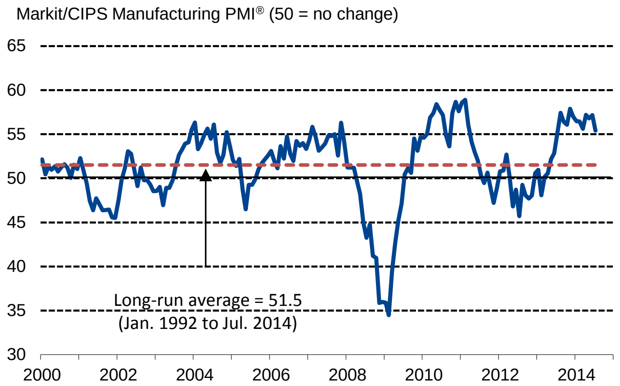
UK Manufacturing

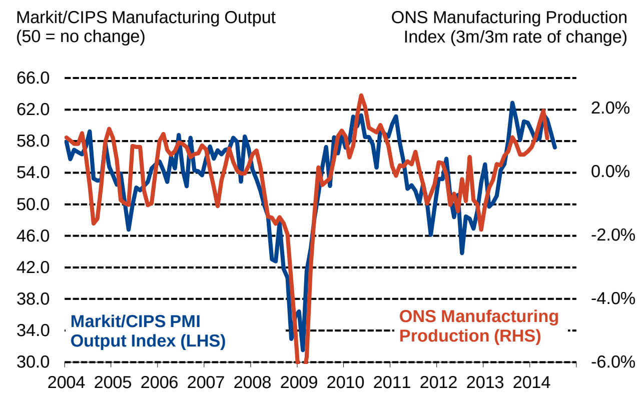
Manufacturing enjoys strong start to third quarter though growth rate cools

The UK manufacturing sector started the third quarter on a firm footing, according to the latest PMI survey published by Markit and CIPS. The headline PMI posted 55.4 in July, its lowest reading for a year but still well above its long-run average of 51.5.

Despite the cooling seen in July, growth rates for production and new orders also remain well above their long-run trends and are supporting continued solid job creation in the sector. The base of the recovery also remains broad, with robust growth registered in the capital, consumer and intermediate goods sectors, and at SMEs as well as large-scale producers.

The PMI survey therefore paints a positive picture of a solid, broad-based and sustainable recovery. The question remains, however, of how to square this with the much weaker-than-expected May manufacturing production data from the ONS and rising geopolitical tensions, which raise questions about the current and future strength of the sector and the path for policy in the remainder of the year.





Official data to move closer to PMI following May 'blip'

A closer look at the official manufacturing data seems to suggest that the May readings may have been impacted by a number of temporary factors, not just in the UK but also across much of the European Union. On this basis we are likely to see a sharp rebound in the official manufacturing measure in June, as these effects are reversed, followed by further robust gowth in July.

The latest GDP estimate from the ONS had already penciled in a 0.4% rebound in industrial production in June. The rebound is likely to be stronger than this, especially for manufacturing on its own, which would take the picture for the second quarter as a whole more in line with that signalled by the manufacturing PMI.

The Bank of England will not be overly worried by the weaker numbers, as policymakers were already expecting growth to slow slightly from the impressive rate seen in first half of the year. More important is that the rate of growth in manufacturing remains sufficiently strong to help contribute to yet another robust expansion of the economy in the third quarter.

Uncertainty remains as geopolitical tensions increase

The concern is that the slowdown we are seeing is also a symptom of increased economic uncertainty both at home and in key export markets of Europe, in turn fuelled by worries about the Ukraine crisis. If the situation with Russia deteriorates further, we should expect goods exports to come under further pressure. Manufacturing growth could also be impacted if sanctions targeting the Russian energy sector also translate into higher European energy prices.

It remains too early to gauge the impact of the Ukraine crisis, but the worry is that the combined effects of expected policy tightening, heightened economic uncertainty and sluggish trade could mean manufacturing growth could suddenly weaken more than expected. Policymakers will therefore be hoping to see service sector PMI numbers offsetting any export-led weakness in manufacturing.

Either way, a backdrop of slower growth, low inflationary pressures, and rising geopolitical tensions make it even more likely that any move towards raising interest rates will be pushed back into early 2015, regardless of the ongoing strength of economic growth.

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