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Markit Economic Research

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UK economy

Q1 GDP boosted by output, investment and inventories

Output growth strengthened in Q1

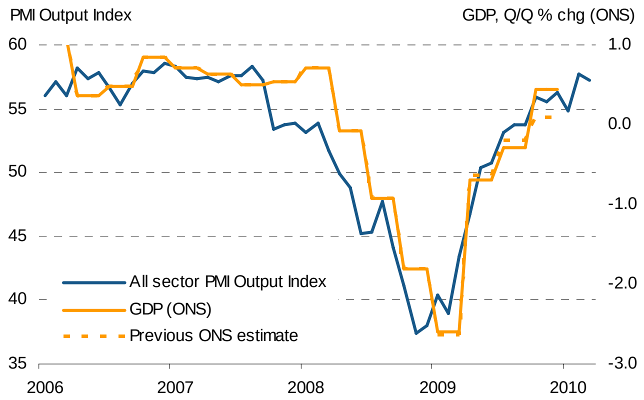
At 57.2, the 'all-sector' PMI Output Index, which combines business output and activity measures from the services, manufacturing and construction CIPS/Markit surveys, remained well above the 'no-change' level of 50.0 in March to signal an ongoing robust expansion of private sector output.

The index slipped from 57.7 in February, which was the highest reading since August 2007. However, anecdotal evidence from the surveys suggests that severe weather had affected business trends during the first quarter, and that the dip in the March reading merely represents a consolidation from an unusually buoyant February. February's index had been boosted by many businesses returning to normal from weather-related disruptions in January.

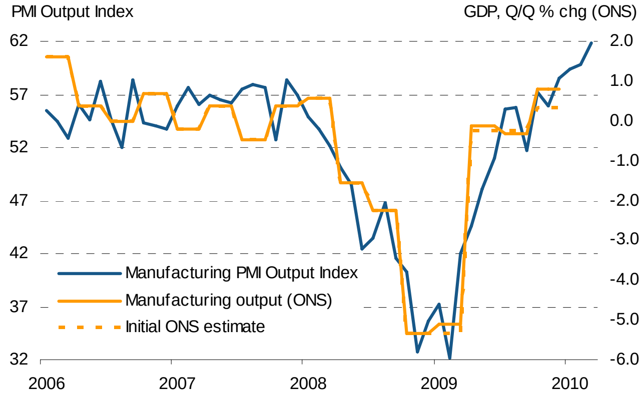
A more reliable indication of the underlying trend can therefore be gleaned from the average index reading for Q1 as a whole. The surveys point to the strongest rate of growth since 2007 Q3 (the index averaged 56.6 in Q1, up from 55.9 in Q4 of last year).

Comparing the PMI readings with recent gross domestic product (GDP) data, the average reading for the 'all-sector' PMI Output Index is consistent with GDP rising by approximately 0.5% in Q1, suggesting an improvement on the Office for National Statistics' latest estimate for Q4 2009 of 0.4% (revised up from the second estimate of 0.3% and an initial 0.1%).

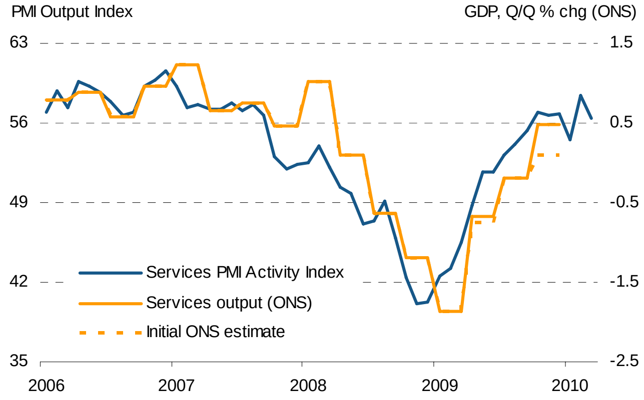
GDP



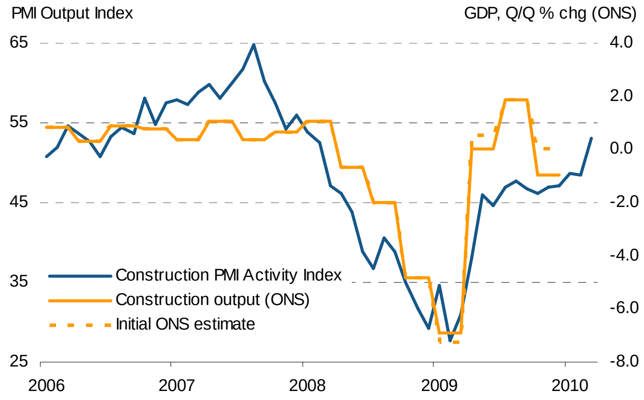
Manufacturing



Services



Construction



Sources for all charts: Markit, ONS.

Manufacturing leads, followed by services. Construction stabilises.

Both the PMI surveys and revised official data show that **manufacturing** has led the upturn, with the PMI data indicating that the sector will have built further momentum in Q1 on the 0.8% increase in production seen in 2009 Q4 (the manufacturing PMI Output Index has averaged 60.4 in Q1 compared to 57.2 in Q4, consistent with quarterly growth in excess of 1%).

Both the PMI survey and official data show that **services** growth gained momentum at the end of last year, but lags manufacturing – a trend which looks set to have continued in Q1. With the PMI index for services averaging 56.4 in Q1 against 56.8 in Q4, growth of the sector in Q1 is likely to be similar to the 0.5% increase seen in Q4. However, the PMI data still suggest that GDP may be understating the strength of the service sector recovery somewhat.

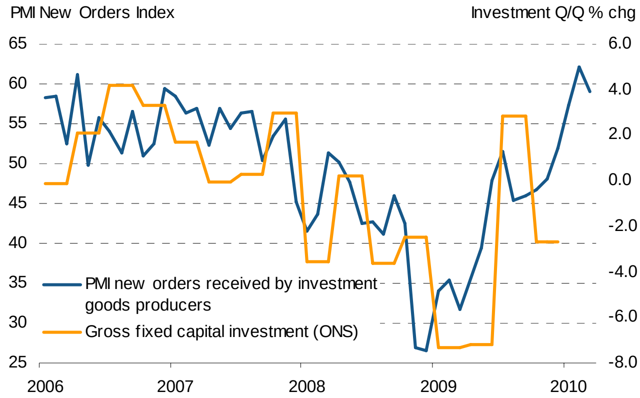
Construction showed the steepest contraction during the recession, according to both PMI and official data. While the PMI figures have plotted a smooth easing trend in the rate of contraction over the past year, official data have been far more volatile, which has made comparisons difficult. However, the survey suggests that the sector has at last stabilised: the PMI's Construction Activity Index averaged 50.1 in Q1, up from 46.7 in Q4 data, rising above the no-change level for the first time in two years.

Investment and inventories set to provide support to economy

Further encouragement for GDP prospects in Q1 are provided by PMI sub-indices, which suggest that other aspects of GDP outside of output are also recovering. With an ongoing manufacturing-led recovery in output gathering momentum and becoming increasingly broad-based, spreading to services and construction, the PMI surveys indicate that businesses are beginning to rebuild inventories and raise expenditures on investment.

GDP was dragged down in Q4 by a fall in investment (gross fixed capital formation fell 2.7%). However, the manufacturing PMI's index for new orders received at companies which produce investment goods (such as plant and machinery) correlates well with the official data on business investment, and shows a clear upward trend in recent months. Although the index dipped slightly in March, the quarterly average was over 10 points up on Q4 and the highest since 1995 Q1, suggesting a marked increase in investment during the first quarter of 2010.

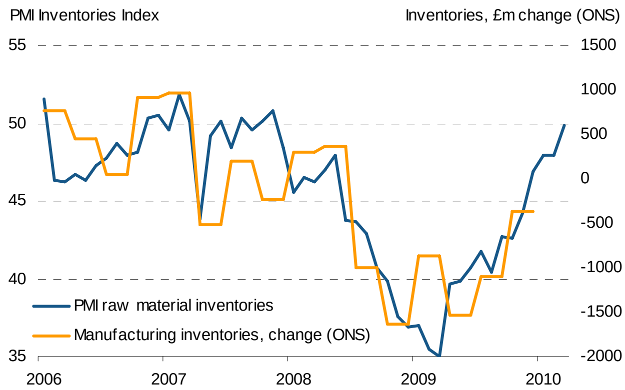
Investment



Sources: Markit, ONS.

The recession was also characterised by a sharp cut in inventories as firms sought to reduce overheads. This continued in Q4 with a further £2.6bn drop in inventories (including a £368m fall in manufacturing stock holdings) according to the ONS. But companies may have at last started to rebuild inventories in early-2010. The manufacturing PMI survey's index of stocks of purchases, which has a good correlation with official inventory data, rose in March to its highest level since November 2007, and is consistent with an increase in the official inventory data in Q1.

Inventories



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