

UK manufacturing

Manufacturing growth stalling as export surge fades

- **Manufacturers' inflows of new orders fall for second month running.**
- **Stalling of export sales linked to slower global economic growth.**
- **But export sales of capital goods show ongoing strength.**

Manufacturing growth surge stalls

The Markit/CIPS Manufacturing PMI™ fell to 51.3 in June, down from 52.0 in May and the lowest reading since September 2009. The near-stagnation signalled by the index represents a steep deterioration in the performance of the sector since the surging growth seen at the start of the year.

The output component of the PMI signalled an increase in production compared to May, but remained at a low level, consistent with no growth in the three-month-on-three month rate of change as measured by official data from the Office for National Statistics.

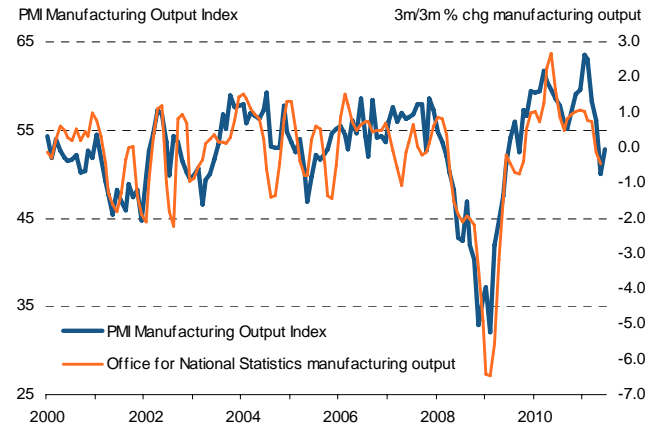
The new orders component of the PMI was even more disappointing, registering a reduced inflow of new orders for the second successive month. The decline reflected an ongoing weakness of domestic demand, but also a worrying near-stagnation of new export orders.

Export sales hit by slower global growth

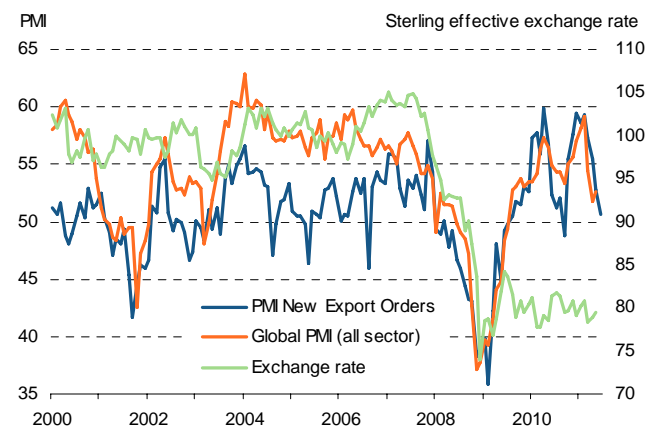
The turnaround in export performance is easy to explain in terms of worldwide economic growth trends and the exchange rate. Our chart maps the UK PMI Export Orders Index against the Global PMI (a reliable indicator of worldwide economic growth) and the exchange rate (we use the Bank of England's trade-weighted index) since 2000.

The chart shows that UK exports are – not surprisingly – closely correlated with worldwide economic growth. However, in the years leading up to the financial crisis in 2007/08, UK export growth had a tendency to lag well behind the pace of global economic growth. This

Manufacturing production



Manufacturing exports



Sources: Markit, Office for National Statistics, Bank of England, JPMorgan

has not been the case since the recovery from the recession. During this period, UK export growth has tended to match the rate of worldwide growth, as depicted by the Global PMI (note that the two PMI indices use the same left hand scale).

The sub-par performance of UK exports before, and par trend since, the recession can be explained by the exchange rate. Sterling fell compared to key currencies (notably the US dollar and euro) during the financial crisis and, measured against a basket of currencies, has traded over the past three years at an average some 18% below the pre-crisis average. The combination of the competitive boost received to

sellers of UK-made goods in overseas markets and the steep upturn in global growth has been a key driver of the UK economic recovery.

The variation in export growth since the recession has also clearly been a function of global demand, and the recent slowing of export sales is a reflection of the Global PMI having fallen from a near five-year high in February to a post-crisis low in April, with only a slight uptick in May.

The latest data therefore raise concerns about the ability of UK manufacturing to continue to help sustain a robust economic recovery. After all, the advantages of a competitive exchange rate fade if there is no demand for goods in overseas markets.

Supply chain delays may have eased, but global demand remains subdued

Much therefore depends on the course that the global economy will take in the second half of the year. It is likely that the recent slowdown in global growth is at least in part attributable to the earthquake in Japan, which hit domestic activity in the country and disrupted

supply chains across the globe. As business returns to normal, growth should pick up, with UK exports following. On the other hand, slumping consumer demand in key Eurozone export markets and the US, plus policy tightening in China and other emerging markets, are likely to continue to act as major counteracting drags on demand for UK exports.

Signs of business optimism

Some optimism for the longer term outlook may be warranted, however, by the fact that the easing in export sales has been driven by weakness for consumer goods and intermediate goods (the latter being manufactured inputs bought by other companies). In contrast, sales of capital goods (plant and machinery) remained strong. The sustained demand for capital goods suggests that businesses around the world continue to invest in the expansion of capacity, anticipating economic growth to revive again in coming months.

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