

UK Economy

PMI™ survey rebound lifts prospects for GDP upturn in Q3

- All-sector PMI™ at 52.7 in September, up from 50.9 in August.
- PMI model signals 0.4% GDP rise in Q3, but masks weaker underlying trend.
- 2011 GDP growth to struggle to exceed 1.0%.

The PMI surveys indicate that private sector economic growth picked up in September, with upturns in services and manufacturing offsetting stagnation in construction. The weighted average of the Output Indices from the three Markit/CIPS PMI™ surveys rose to 52.7 from a 26-month low of 50.9 in August.

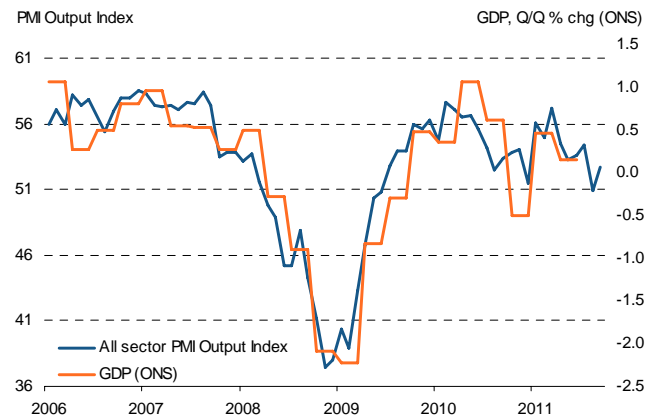
The improvement lifts the prospects for GDP growth in the third quarter. Having expanded by just 0.2% in the second quarter, the economy may have expanded by 0.4% in the three months to September, according to a model which combines PMI and any relevant official data that are so far available for the quarter.

The rise in the index in September may therefore persuade the Monetary Policy Committee to hold off before implementing any further stimulus at its October meeting. Policymakers may choose to wait until more evidence on the health of the economy becomes available with the publication of October surveys, third quarter GDP data and the Bank's updated forecasts.

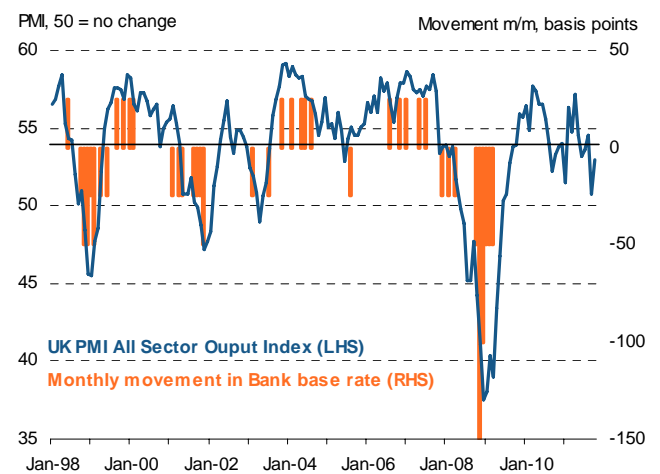
However, the case is by no means clear cut. The MPC may choose to focus on signs that the underlying trend in economic growth has weakened as austerity measures bite at home, the Eurozone crisis continues to escalate and global growth has weakened. Business confidence about the year ahead is running at levels only ever seen before in periods of crisis

Note also that the 0.4% estimate of GDP is based on the expectation that official data (notably for manufacturing) are likely to show that business levels rebounded to a greater extent than the PMI surveys suggest from temporary disruptions in the second quarter, notably the royal wedding, the additional bank holiday and supply chain problems emanating out of Japan. Looking purely at the PMIs, GDP may have expanded by just 0.1% in the third quarter.

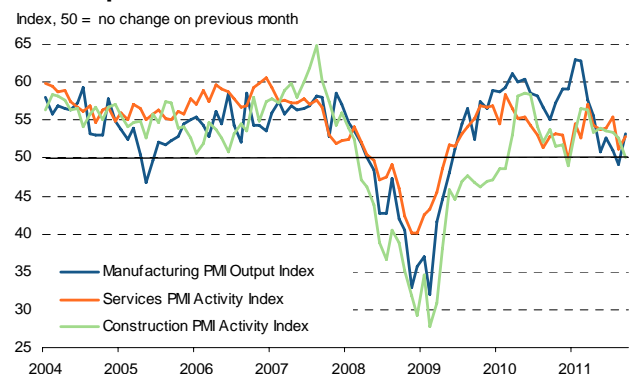
All sector PMI and GDP



PMI and Bank of England rate setting



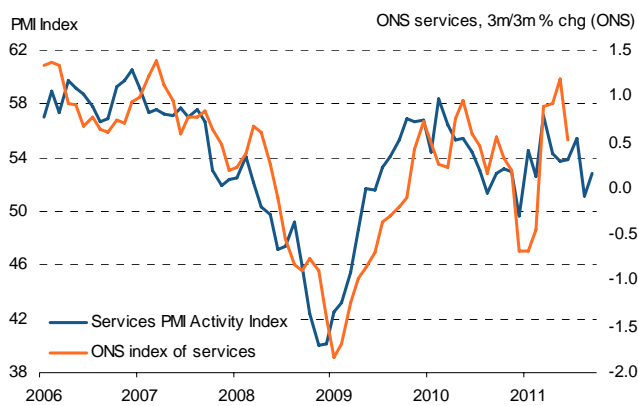
PMI Output Indices



Services index shows improved growth

Looking at the detail, service sector activity bounced back from August's eight-month low of 51.1, but at 52.9 the Activity Index still recorded the second-weakest expansion seen so far this year. For Q3 as a whole, the survey indicated an easing in the rate of growth for the second quarter running (an average of 53.1 compared to 54.0 in Q2), but still suggests that the sector continued to contribute to the economic recovery in Q3, expanding by approximately 0.4% compared to 0.5% in Q2.

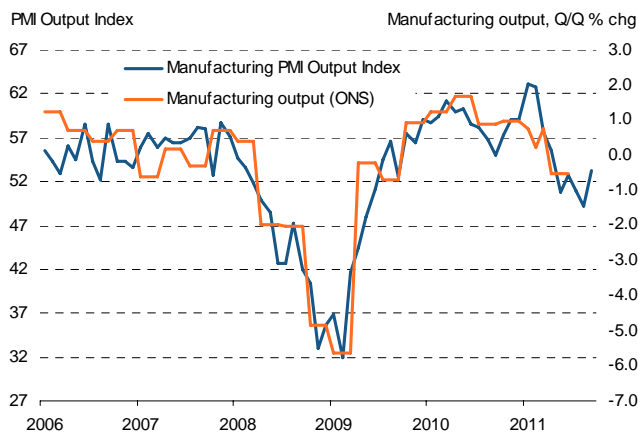
Service sector output



Manufacturing recession?

Manufacturing also saw growth of output recover in September, the PMI Output Index rising from 49.2 in August to a five-month high of 53.3. However, the average reading for Q3 as a whole was just 51.2, down from 53.0 in Q2 and 61.2 in Q1. Comparisons therefore suggest that the manufacturing sector may have contracted in Q3 at a faster rate than the 0.5% decline signalled by official data in Q2, falling at a quarterly rate of 0.6-0.7%.

Manufacturing output

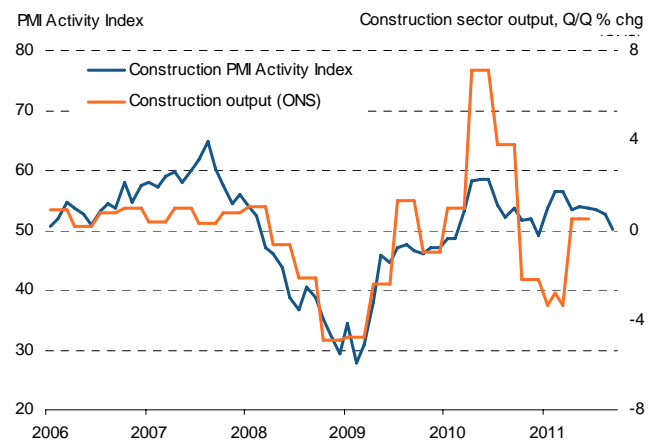


However, it should be noted that official data may well be more buoyant than the PMI in Q3, in part reflecting a bigger rebound from temporary disruptions to business in Q2. Manufacturing growth could even support an increase in the wider measure of industrial production of perhaps 0.1%.

Construction 'recovery' sustained in Q3

The PMI Business Activity for construction fell from 52.6 in August to 50.1 in September, finishing off the weakest quarter since the snow-affected final quarter of last year. The PMI and official data appear to be falling back into line after strong volatility in the latter caused the series to diverge in 2010 and early 2011. The PMI suggests that construction expanded in Q3 by less than the 0.5% seen in Q2, rising just 0.3%.

Construction activity



Confidence in the doldrums, points to weak Q4

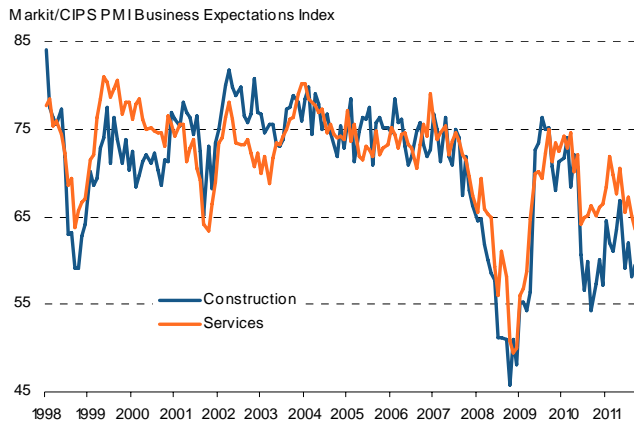
Business confidence about the year ahead slipped to its lowest since March 2009 in the service sector, and recovered only modestly in construction. In both cases, confidence is running at levels only ever seen before in periods of crisis (similar data are not available for manufacturing).

Furthermore growth of activity in recent months has been fuelled by manufacturers and service providers eating into their backlogs of orders, which suggests that activity may weaken in the final quarter unless growth of new orders revives. The downturn in business confidence suggests that such a revival is unlikely.

Even if the official GDP data show a rise of 0.4% in Q3 and the economy grows by an optimistic-looking 0.3%

in Q4 that would leave GDP up just 1.2% for 2011 as a whole. Any economic forecast exceeding this looks altogether unrealistic.

Optimism about the year ahead



Sources for charts: Markit, ONS, Ecowin, Bank of England.

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