Private sector returns to growth in January as receding political uncertainty lifts order books

Key data

Flash UK Composite Output Index
Jan: 52.4, 16-month high (Dec final: 49.3)

Flash UK Services Business Activity Index
Jan: 52.9, 16-month high (Dec final: 50.0)

Flash UK Manufacturing Output Index
Jan: 49.5, 8-month high (Dec final: 45.6)

Flash UK Manufacturing PMI
Jan: 49.8, 9-month high (Dec final: 47.5)

January data from the IHS Markit / CIPS Flash UK Composite PMI® highlighted a decisive change of direction for the private sector economy at the start of 2020. Business activity expanded for the first time in five months, driven by the sharpest increase in new work since September 2018.

The seasonally adjusted IHS Markit / CIPS Flash UK Composite Output Index – which is based on approximately 85% of usual monthly replies – rose to 52.4 in January, from 49.3 in December. As a result, the headline index registered above the crucial 50.0 no-change mark for the first time since August 2019.

The latest reading was the highest for almost one-and-a-half years and signalled a moderate expansion of business activity across the UK private sector economy. There were widespread reports that reduced political uncertainty following the general election had a positive impact on business and consumer spending decisions at the start of the year.

Service providers experienced solid increases in business activity and incoming new work in January. Meanwhile, the performance of the manufacturing sector stabilised in comparison to the end of 2019, but still trailed behind the service economy amid ongoing weakness in export markets.

Employment numbers increased for the second month running in January, with marginal growth seen in both the manufacturing and service sectors.

Additional staff hiring was supported by a sustained rebound continued...
in output growth projections for the next 12 months, with business optimism reaching its highest level since June 2015. Survey respondents often commented on hopes that an end to domestic political indecision will have a favourable impact on business investment and help to sustain a more favourable economic landscape.

Input price inflation meanwhile accelerated in January and was the highest for four months. Greater salary payments were reported as the main source of pressure on operating expenses, although manufacturers also noted rising commodity prices and higher costs for imported materials.

Efforts to alleviate the squeeze on margins resulted in a solid increase in average prices charged by private sector firms at the start of 2020. Some businesses also suggested that improving demand conditions had allowed greater scope to pass on higher operating costs. Measured overall, the latest rise in average prices charged was the fastest since May 2019.

IHS Markit / CIPS Flash UK Manufacturing PMI®
At 49.8 in January, the seasonally adjusted IHS Markit/CIPS Flash UK Manufacturing Purchasing Managers’ Index® (PMI®) – a composite single-figure indicator of manufacturing performance – picked up from 47.5 in December and was the highest since April 2019. The latest PMI reading was only fractionally below the neutral 50.0 threshold and signalled a broad stabilisation of business conditions across the manufacturing sector at the start of 2020. Higher levels of new work and a slight rise in employment were positive contributions to the index, while a sharp and accelerated fall in stocks of purchases was the main negative influence.

Manufacturing production meanwhile fell at a much slower pace than in December, with the latest reduction only marginal and the smallest since the current phase of decline began in June 2019. Lower output was linked to a lack of pressure on operating capacity and, in some cases, the ability to fulfil orders from inventories accumulated to deal with Brexit uncertainty.

IHS Markit / CIPS Flash UK Services PMI®
The seasonally adjusted IHS Markit/CIPS Flash UK Services PMI® Business Activity Index posted 52.9 in January, up sharply from 50.0 in December and the highest reading since September 2018. Mirroring the trend for business activity, latest data also revealed the sharpest increase in new work for 16 months.

Survey respondents suggested that receding political uncertainty boosted service sector activity at the start of the year. A number of service providers commented on the receipt of new business that had been delayed ahead of the general election. Sales to clients in overseas markets remained subdued in January, continuing the downward trend seen in the final quarter of 2019.

Looking ahead, service sector firms recorded a rebound in business optimism to its highest since March 2015, which was linked to improved expectations for both domestic demand and the global economic outlook.

Comment
Commenting on the latest survey results, Chris Williamson, Chief Business Economist at IHS Markit, said:

“The survey data indicate an encouraging start to 2020 for the UK economy. Output grew at the fastest rate for sixteen months amid rising demand for both manufacturing and services, suggesting business is rebounding after declines seen late last year. Intensifying political and economic uncertainty ahead of the general election has started to ease, encouraging more spending and helping push business expectations of future growth to its highest since mid-2015.

“The survey is indicative of GDP rising at a quarterly rate of approximately 0.2% in January, representing a welcome revival of growth after the malaise seen in the closing months of 2019. Hiring has also picked up.

“The uplift in sentiment about the outlook hints at even better growth to come, but confidence needs to continue to rise to ensure this solid start to the year has legs.

“It seems likely that the rise in the PMI kills off the prospect of an imminent rate cut by the Bank of England, with policymakers taking a wait and see approach as they assess the performance of the economy in the post-Brexit environment.”

Duncan Brock, Group Director at the Chartered Institute of Procurement & Supply, said:

“January saw market conditions starting to build, as revitalized supply chain managers in the manufacturing and services sectors reported the highest growth of new orders since September 2018. It appears that once uncertainty around the General Election was removed, domestic clients and consumers started to spend again, though exports in the service sector still suffered from indecision and a Brexit block.

“Prospects around the future improved through an injection of confidence not seen June 2015. It was only the unravelling of stock in the manufacturing sector that prevented a further rise in purchasing activity and new orders, as threats around disrupted supplies receded. Staff numbers also rose marginally in both sectors, as did input price inflation in response to employees and raw materials becoming more expensive.

“2020 has started on a positive note with this sudden change in momentum. However, that's where the story will end until this uncorked trickle of new orders and activity turns into a flood for businesses hit by hesitancy in the last three years. Business activity will need to be buoyed up by the prospect of strong negotiations around the UK’s exit from the EU to return them to strength in the years to come.”
Survey methodology

The IHS Markit / CIPS Flash UK Composite PMI® is compiled by IHS Markit from responses to questionnaires sent to survey panels of around 650 manufacturers and 650 service providers. The panels are each stratified by detailed sector and company workforce size, based on contributions to GDP. The services sector is defined by IHS Markit as consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. The following variables are monitored:

- Manufacturing: Output, new orders, new export orders, backlogs of work, stocks of finished goods, employment, quantity of purchases, suppliers’ delivery times, stocks of purchases, input prices, output prices, future output.

A diffusion index is calculated for each manufacturing and services variable. The index is the sum of the percentage of ‘higher’ responses and half the percentage of ‘unchanged’ responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

Composite indices are calculated by weighting together comparable manufacturing and services indices using official manufacturing and services annual value added.

The headline figure is the Composite Output Index. This is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. It may be referred to as the ‘Composite PMI’ but is not comparable with the headline Manufacturing PMI, which is a weighted average of five manufacturing indices (including the Manufacturing Output Index).

The headline manufacturing index is the Manufacturing Purchasing Managers’ Index® (PMI®). The PMI® is a weighted average of the following five indices: New Orders (30%), Output (25%), Employment (20%), Suppliers’ Delivery Times (15%) and Stocks of Purchases (10%). For the PMI® calculation the Suppliers’ Delivery Times Index is inverted so that it moves in a comparable direction to the other indices.

The headline services index is the Services Business Activity Index. This is a diffusion index calculated from a single question that asks for changes in the volume of business activity compared with one month previously. The Business Activity Index is comparable to the Manufacturing Output Index. It may be referred to as the ‘Services PMI®’ but is not comparable with the headline Manufacturing PMI.

Flash data are calculated from around 80-90% of total responses and are intended to provide an accurate early indication of the final data. Since flash data were first processed, the average differences between final and flash index values for the headline indices are:

- Composite Output Index = 0.0 (absolute difference 0.4)
- Services Business Activity Index = 0.0 (absolute difference 0.3)
- Manufacturing PMI = 0.0 (absolute difference 0.3)

Underlying final survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

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