Service sector growth falters in May

Spain’s service sector continued to expand during May, but at a slower rate as new business growth weakened to its lowest level for over five-and-a-half years. The slowdown meant firms took on additional staff at a weaker pace as capacity pressures dissipated.

Meanwhile, confidence about the future was only slightly up on April’s 68-month low, whilst margins came under renewed pressure: operating expenses continued to rise markedly, but strong market competition weighed on firms’ own pricing power.

The headline Business Activity Index weakened to 52.8 in May. That was down from 53.1 and a second successive monthly fall from March’s 13-month high. Moreover, whilst solid and above the long-run average, the latest increase in activity was the weakest recorded by the survey since last September.

Undermining growth of activity was a similar slowdown in new business expansion. Panellists commented that market demand had softened since the previous month, in part undermined by political instability following the recent elections. However, service providers also faced a reduction in demand from abroad, as signalled by a decline in exports for the second time in the past three months.

The slowdown in growth of new work meant that service providers on the whole were able to keep on top of their existing workloads. Companies signalled little change in work outstanding following a modest increase in the previous month. Expanded labour capacity also aided firms’ efforts to deal with the dual demands of new and existing business. May’s survey showed a net increase in jobs to thereby extend the current run of continuous jobs growth to 56 months. However, in line with the slowdown in activity and new business expansion, the degree to which payroll numbers increased was the weakest since last October.

Increased labour costs remained a key factor pushing up company operating expenses during May. Allied with many reports of higher prices related to transportation, overall operating expenses increased in May at the fastest pace for three months.

In contrast, competitive pressures meant firms struggled to pass on their higher costs to customers. Although charges were increased in May, inflation was only modest and the weakest since last October.

Looking ahead to the coming year, many firms were confident of a return to political stability, general market expansion and higher order levels. However, there remained some worries over Brexit, US-China trade tensions and the current domestic political situation, which all served to undermine confidence. Although optimism was a little firmer in May it nonetheless remained close to April’s recent low.
The Spanish private sector economy expanded at its slowest rate for five-and-a-half years during May as signalled by the Composite Output Index*, which recorded 52.1, down from 52.9 in April.

The manufacturing economy was the primary source of the slowdown in growth. According to May’s data, the manufacturing economy stagnated, with production failing to rise for the first time since November 2013. The services economy, in contrast, continued to expand solidly, albeit at its weakest rate since last September.

The under-performance of the manufacturing sector was linked to a fall in new work for the second time in the past four months. Service providers recorded growth, albeit to only a modest degree that was the weakest since September 2013. There were reports from both sectors that political uncertainty following recent elections had undermined sales in May. Worries over the political environment also weighed on sentiment. According to May’s survey, overall business confidence in the Spanish private sector was at its lowest for six months and amongst the weakest in the past six years.

Manufacturing payroll numbers were cut for the first time since late 2013 although, with services continuing to add jobs, employment growth was sustained. Input costs rose to the greatest degree for six months.

*Composite PMI indices are weighted averages of comparable manufacturing and services PMI indices. Weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Spain Composite Output Index is a weighted average of the Spain Manufacturing Output Index and the Spain Services Business Activity Index.

Commenting on the PMI data, Paul Smith, Economics Director at IHS Markit said:

“Spanish economic growth stuttered midway through the second quarter as manufacturing production stagnated and services expansion weakened on the back of weaker gains in new work. At its current level, the PMI data are indicative of slower GDP growth for the second quarter as a whole.

“The slowdown is linked to a combination of political instability at home following the recent elections, which has undermined domestic demand, plus ongoing softness in foreign sales as trade tensions weigh on global economic activity.

“With little sign of a resolution to these issues, Spanish companies are understandably increasingly worried about the future as signalled by a deterioration in sentiment to a six-month low.”
Methodology

The IHS Markit Spain Services PMI® is compiled by IHS Markit from responses to questionnaires sent to a panel of around 350 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey 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.

The headline figure is the Services Business Activity Index. This is a diffusion index calculated from a question that asks for changes in the volume of business activity compared with one month previously. The Services 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 figure.

The Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Composite Output Index may be referred to as the "Composite PMI" but is not comparable with the headline manufacturing PMI figure.

Underlying 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.

May 2019 data were collected 13-28 May 2019.

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