UK service providers signal subdued end to 2018

KEY FINDINGS

- Modest rises in business activity and new work
- Job creation eases to 29-month low
- Business confidence at second-lowest level since 2009

Subdued growth conditions persisted across the UK service sector at the end of 2018, with business activity rising at one of the slowest rates seen over the past two-and-a-half years. New work increased only marginally during December, which contributed to a slowdown in job creation to its weakest since July 2016. The main positive development for the service sector has been a softer pace of input cost inflation on average in the final quarter of 2018, as lower fuel prices helped to offset some of the pressure on operating expenses from rising staff wages.

The headline seasonally adjusted IHS Markit/CIPS UK Services PMI® Business Activity Index registered 51.2 in December, up only slightly from the 28-month low seen in November (50.4). Reports from survey respondents suggested that Brexit-related concerns were a key factor weighing on business-to-business spending at the end of 2018. A number of firms also noted that subdued consumer demand had acted as a brake on sales in December.

Mirroring the trend for business activity, latest data indicated that growth of new work picked up only sightly from the 28-month low seen in November. Survey respondents commented on a headwind from political uncertainty and downbeat projections among clients in relation to domestic economic growth in 2019.

Another relatively weak rise in business and consumer spending contributed to a lack of new work to replace completed projects in December. This was highlighted by a drop in backlogs of work at service providers for the third month running, which is the longest period of decline since the summer of 2016.

Reduced pressure on operating capacity and efforts to cut costs contributed to softer employment growth across the service sector in December. The latest upturn in staffing levels was only marginal and the weakest recorded for almost two-and-a-half years. Nonetheless, there were still widespread reports that tight labour market conditions had made it difficult to recruit suitably skilled staff.

Higher wages were cited as a key factor leading to rising input costs at service providers in December. There were also reports that greater food prices and higher costs for imported items had pushed up operating expenses. The overall rate of cost inflation edged up only slightly from November’s six-month low.

December data indicated a moderation in business optimism across the service economy for the third month running. Moreover, the degree of confidence towards business activity in the coming year is now the second-weakest recorded by the survey since March 2009. Worries about the impact of Brexit uncertainty on business investment and consumer demand remained by far the most prominent issues cited by survey respondents at the end of last year.
UK private sector output rises at slightly faster pace

All Sector PMI indices are weighted averages of comparable manufacturing, construction and services PMI indices. Weights reflect the relative size of the manufacturing, construction and service sectors according to official GDP data.

The UK All Sector Output Index is a weighted average of the UK Manufacturing Output Index, the UK Total Construction Activity Index and the UK Services Business Activity Index.

At 51.6 in December, the seasonally adjusted All Sector Output Index was up slightly from 51.0 in November. However, the latest reading pointed to the second-slowest rate of business activity expansion since July 2016.

Comment

Chris Williamson, Chief Business Economist at IHS Markit, which compiles the survey:

“The service sector typically plays a major role in driving economic growth, but is now showing worrying signs of having lost steam amid intensifying Brexit anxiety. The final two months of 2018 saw the weakest back-to-back expansions of business activity since late-2012 and highlight how clarity on Brexit is needed urgently in order to prevent the economy sliding into contraction.

“Combined with disappointing growth in the manufacturing and construction sectors, the meagre service sector expansion recorded in December is indicative of the economy growing by just 0.1% in the closing quarter of 2018.

“Although increased preparations for a potentially disruptive ‘no deal’ Brexit are helping to boost business activity in some cases, notably in manufacturing, heightened Brexit uncertainty is compounding a broader economic slowdown. Measured across all sectors, business optimism is down to the third-lowest since comparable data were first available in 2012.

“Even the current slow growth of business activity is only being achieved by firms eating into back orders, suggesting that operating capacity could be reduced in coming months unless new order inflows pick up. Employment growth is already faltering as firms took a more cautious approach to hiring. Both manufacturing and services have seen previously solid hiring trends stall to near-stagnation, underscoring how the uncertainty faced by businesses will inevitably feed through to households as the job market deteriorates.”

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

“The cold winds from the continued EU crisis resulted in the weakest rise in services employment since July 2016 as consumers were reluctant to spend and clients once again delayed orders.

“The pressures of higher wage demands added to input costs, though there was some reprieve in the shape of lower fuel prices. This was not enough to prevent businesses passing costs on to clients at the fastest rate since June 2018 as the expense of the right staff and business overheads ate into precious margins.

“Whilst overall the services sector still grew, it was at a restrained rate as businesses remain under the Brexit cosh. Indecision is squeezing the life out of activity, new orders, and consumer confidence and with the gloomiest expectations for the future since July 2016, the sector is moving through a dark tunnel without a speck of light at the end it seems.”
Methodology
The IHS Markit / CIPS UK Services PMI® is compiled by IHS Markit from responses to questionnaires sent to a panel of around 650 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 whether the volume of business activity increased, decreased or remained unchanged compared to the previous month. 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 All Sector Output Index is a weighted average of the Manufacturing Output Index, the Construction Total Activity Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing, construction and service sectors according to official GDP data.

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.

December 2018 data were collected 5-19 December 2018. For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.