Service sector output and employment fall at much slower pace in February

**KEY FINDINGS**

- Business activity almost stable in second month of lockdown
- Slowest drop in staffing numbers since pandemic began
- Optimism continues to rise in response to vaccine roll out

February data indicated that a degree of stability returned to the UK service sector after the sharp downturn in output at the start of 2021. Restrictions on travel, leisure and hospitality due to the national lockdown continued to curtail overall activity, but there were some pockets of growth in technology and business services.

Staffing levels decreased at the slowest pace since the coronavirus disease 2019 (COVID-19) pandemic first hit employment numbers last March. Furlough arrangements again softened the degree of job shedding among consumer service providers, while there were also reports that improving optimism towards the business outlook had helped to stabilise employment.

Vaccine roll out progress and confidence about the prospect of looser restrictions on trade resulted in a fourth consecutive monthly rise in business expectations across the service economy.

The headline seasonally adjusted IHS Markit/CIPS UK Services PMI® Business Activity Index registered 49.5 in February, up sharply from an eight-month low of 39.5 in January. The headline index has posted below the crucial 50.0 no-change mark in each month since November 2020, but the latest reading signalled the slowest decline in service sector output over this period.

New business volumes fell only slightly during February, with the rate of contraction easing considerably from that seen at the start of the third national lockdown in January. Subdued demand was mainly attributed to a lack of sales opportunities and hesitancy among clients due to the pandemic. Survey respondents also cited Brexit-related difficulties as a factor holding back sales to customers in the European Union. Latest data indicated that new work from abroad continued to fall sharply. While the rate of decline slowed since January, it remained sharper than that seen for total new orders. International travel restrictions were the most commonly cited reason for lower exports, followed by regulatory and supply chain issues that had arisen since Brexit.

A lack of forward-bookings and reduced pressure on business capacity contributed to another decrease in backlogs of work across the service economy. Moreover, the latest fall in unfinished business was the fastest since June 2020. However, job shedding was only marginal and business expectations for the next 12 months improved in February, with vaccine roll outs and hopes of a sustained economic recovery leading to the highest level of confidence since December 2006.

The latest survey highlighted a sharp and accelerated increase in average cost burdens at service sector companies. Input price inflation was the strongest for 12 months, with higher fuel bills and greater shipping costs among the most commonly cited reasons in February. Efforts to relieve pressure on margins and, in some cases, improved pricing power due to pent up customer demand, resulted in the fastest rise in output charges across the service sector since February 2020.
UK private sector output fell only slightly in February and the rate of decline was much slower than at the start of the year. At 49.6 in February, up from 41.2 in January, the seasonally adjusted UK Composite Output Index was below the neutral 50.0 value but broadly in line with the average seen during the final two months of 2020. The index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index*.

The gap between manufacturing and service sector performance narrowed considerably in February. Manufacturing production growth eased for the second month running to the weakest since the recovery began last June. While service sector activity remained in decline, the speed of the downturn was much slower than in January.

Employment numbers across the private sector as a whole were close to stabilisation in February (index at 49.7, up from 45.5 in January). Rising staffing levels at manufacturing companies contrasted with a slight reduction in the service economy.

Inflationary pressures intensified during the latest survey period, with overall input prices increasing to the greatest extent since October 2018. Manufacturers recorded a particularly steep rise in purchasing costs and this resulted in the fastest rate of factory gate price inflation for just over three years.

*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.

**COMMENT**

Tim Moore, Economics Director at IHS Markit, which compiles the survey:

“UK service sector activity was relatively stable in February and so it appears that the third national lockdown has seen limited spillovers to parts of the economy beyond the scope of government mandated closures. While customer-facing businesses continued to report severe constraints on activity due to the pandemic, there were signs of growth in technology and some business services after a disappointing start to 2021.

“Tighter restrictions on international travel meant that export sales remained an area of weakness for the service economy. Survey respondents cited regulatory issues and supply disruption as factors holding back new business wins from EU customers, which more than offset the positive impact on overseas demand from the economic recovery in the US and Asia-Pacific.

“Higher fuel bills and shipping costs pushed up operating expenses in February. Service providers have mostly absorbed pressure on margins from rising input costs over the past 12 months, but their latest increase in average charges was the fastest since the start of the pandemic. This often reflected additional charges due to greater transport costs and there were some reports that pent up domestic consumer demand had improved opportunities to raise prices for forward-bookings.”

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

“The dominant services sector bounced back in February and though remained in the contraction zone, presented a more positive picture than at the start of the year. Some growth from non-customer facing businesses helped to stabilise overall levels of activity. Vaccine programmes and the promised uplift in marketplace restrictions offered hope to ailing firms looking forward to a summer of roaring trade as optimism climbed to its highest since December 2006.

“The rain on this parade comes in the form of the highest rise in input costs since February 2020 which is being passed on to consumers at a faster rate, as shipping, fuel and fresh food deliveries went up in price. Added to this, the true employment picture is still hidden by extended furlough schemes making any surge in UK consumer spending limited if job insecurity ramps up and inflation rears its ugly head.

“No large reassurance offered here if border disruption continues for businesses, and any potential tax rises from the Chancellor today increases pressure on an economy damaged by Brexit and the pandemic combined.”