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IHS Markit UK Business Outlook

UK business confidence lowest since October 2011

Key findings:

- UK business optimism falls in June, led by weakest service sector confidence for seven years
- Survey participants link fragile business sentiment to Brexit-related anxiety, domestic political uncertainty and squeezed consumer budgets
- Service providers report least optimistic outlook for corporate profits since 2011
- Subdued expectations for service sector business investment over the next 12 months
- Manufacturers continue to outperform, with capex intentions among the highest since late-2014
- Worries about input cost inflation ease from peak seen in February 2017

Data collected June 12-29

UK business activity expectations



June data from the IHS Markit UK Business Outlook survey highlight a sharp reversal of the upbeat sentiment reported in February 2017.

At +35% in June, the net balance of UK private sector firms expecting a rise in business activity over the next 12 months has dropped markedly from +52% in

February. The latest reading signals the lowest degree of confidence since October 2011.

Fragile business sentiment is linked to deepening concerns about the path to Brexit, a renewed wave of domestic political uncertainty and evidence of more subdued consumer spending.

Service sector anxiety contrasts with upbeat manufacturing firms

The headline picture masks a widening divergence between business optimism in the manufacturing and service sectors. While the latter posts the lowest degree of confidence since June 2010 (a net balance of +32%), manufacturing firms remain relatively upbeat about their growth prospects for the next 12 months (a balance of +49%).

Manufacturing optimism is based to a large extent on gaining sales in overseas markets. Producers link sustained business confidence to the spur to sales received from the weak pound and associated efforts to boost export sales. A number of companies consequently have commented on plans to expand capacity and invest in new products. Manufacturing sector business investment intentions are well above the post-referendum low seen last year (a net balance of +20% compared to a low of +11%).

By contrast, service providers have commented on risk aversion and a reduced willingness to spend among clients, especially those in the domestic business-to-business sector. At the same time, survey respondents report expectations of subdued domestic consumer demand ahead, driven by stretched household budgets.

Within the service sector, Hotels & Restaurants firms are the least optimistic about business activity during the next 12 months, which they link to a combination of fragile demand and rising costs (particularly food prices and staff salaries).

Expectations of weak consumer and business spending had a knock-on effect for service sector profits expectations. The net balance of companies expecting profits to increase exceed those forecasting a decline by just +15%, down from +28% in the prior survey (February) and the lowest since late 2011.

Expectations around profits in the manufacturing sector has slipped from the February survey, but remain well above last year's low and far more buoyant than in the service sector (a net balance of +31%).

Staff hiring plans remain positive in June

Despite a marked decline in expectations for business activity growth, the latest survey indicates that UK businesses remain upbeat about their staff hiring plans. At +22% in June, the net balance of firms anticipating an increase in their employment levels is down only slightly from +27% in February, with hiring intentions remaining close to its post-crisis trend (+21%).

Manufacturing firms (+27%) are more upbeat about their staff hiring plans than service providers (+21%), which continues the trend seen since June 2016.

Inflation expectations moderate

June data indicate that UK businesses' expectations for input cost inflation have moderated from the six-year peak seen in February. However, at +44% in June, down from +54% in the prior survey period, the net balance is still higher than at any time from 2014 to mid-2016.

Reports from survey respondents suggest that the weak exchange rate is expected to remain a key factor pushing up input costs in the next 12 months. UK businesses also note that upward salary pressures are expected to intensify. On the other hand, some manufacturers suggest that lower commodity prices on world markets would help soften cost pressures at their plants.

The net balance of UK firms expecting to raise their prices over the next 12 months has eased markedly from the post-crisis peak seen earlier in 2017. At +34% in June, down from +42% in February, the reading is the lowest seen for one year. Survey respondents have commented that intense competition for new

work and signs of a slowdown in input cost inflation have led to more subdued pricing plans.

Comment:

Commenting on the UK Business Outlook survey data, **Chris Williamson**, Chief Economist at IHS Markit, said:

"Business optimism about future prospects has sunk to its lowest for nearly six years, adding to a growing body of data which point to a slowing economy.

"The drop in confidence pushed the level of UK optimism below that seen in the eurozone for the first time in seven years, and contrasts with multi-year high levels of optimism in the United States and Japan. As such, the survey results suggest the UK is at risk of falling behind in an otherwise solid-looking global economic outlook.

"The survey shows that companies have become increasingly worried about the business outlook, largely as a result of heightened political uncertainties and the potential impact of Brexit.

"The squeeze on household income amid rising inflation, which can be traced to the drop in sterling since last year's referendum, is also a widespread concern. Optimism has consequently fallen especially sharply among domestically-focused service providers.

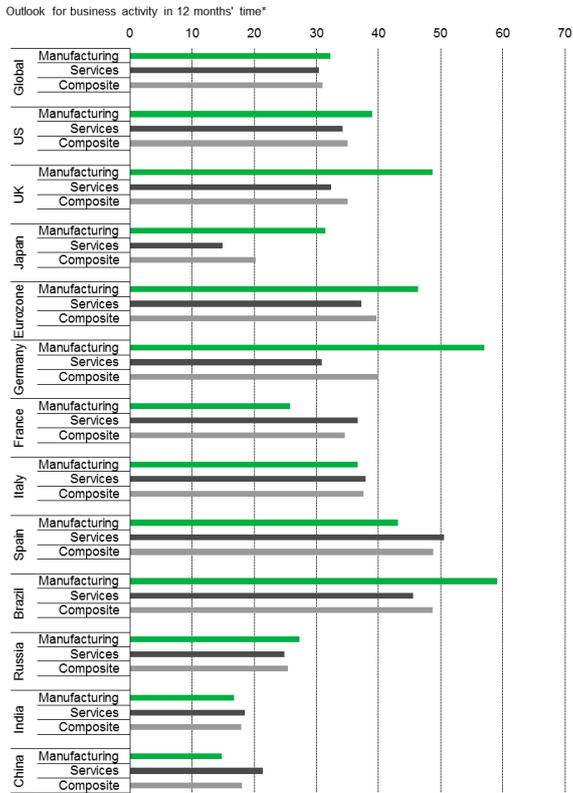
"Manufacturers' hopes are commonly pinned on gains in export markets, often on the back of the weaker exchange rate offsetting sluggish domestic demand. But even the goods producing sector has seen a marked drop in optimism, which tempers hopes that a rebalancing toward trade will drive the economy forward.

"The latest data were collected after the June general election, so may have been affected by the surprise result. However, it was notable the extent to which companies have generally become more concerned about Brexit than in the February survey, in which more of a "cake and eat it" attitude towards exiting the EU had prevailed."

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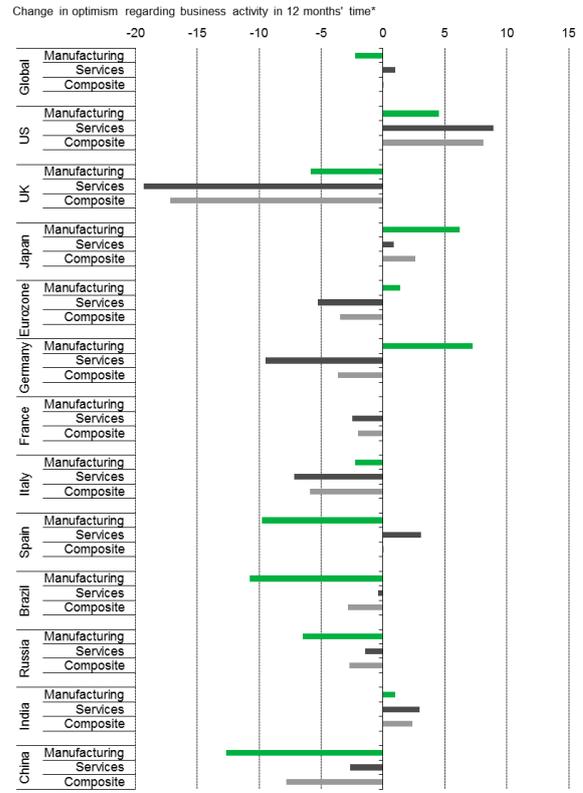
Full data available on request from economics@ihsmarkit.com

Business optimism in June



* chart shows net balance of optimists less pessimists in June.

How business activity expectations have changed since February



* chart shows net balance of optimists less pessimists in June compared to net balance in February.

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Notes to Editors:

The Global Business Outlook Survey for worldwide manufacturing and services is produced by IHS Markit and is based on a survey of around 12,000 manufacturers and service providers that are asked to give their thoughts on future business conditions. The reports are produced on a tri-annual basis, with data collected in February, June and October. The latest survey was conducted between June 12 and 29.

Interest in the use of economic surveys for predicting turning points in economic cycles is ever increasing and the Business Outlook survey uses an identical methodology across all nations covered. It gives a unique perspective on future business conditions from Global manufacturers and service providers.

The methodology of the Business Outlook survey is identical in all countries that IHS Markit operates. This methodology seeks to ensure harmonization of data, and is designed to allow direct comparisons of business expectations across different countries. This provides a significant advantage for economic surveillance around the globe and for monitoring the evolution of the manufacturing and services economies by governments and the wider business community.

Data collection is undertaken via the completion of questionnaires three times a year at four-month intervals. A combination of phone, fax, website and email are used, with respondents allowed to select which mechanism they prefer to use.

The Business Outlook survey uses net balances to indicate the degree of future optimism or pessimism for each of the survey variables. These net balances vary between -100 and 100, with a value of 0.0 signalling a neutral outlook for the coming twelve months. Values above 0.0 indicate optimism amongst companies regarding the outlook for the coming twelve months while values below 0.0 indicate pessimism. The net balance figure is calculated by deducting the percentage number of survey respondents expecting a deterioration/decrease in a variable over the next twelve months from the percentage number of survey respondents expecting an improvement/increase.

Questionnaires are sent to a representative panel of around 12,000 manufacturing and services companies spread across the global economy in the countries mentioned above. Companies are carefully selected to ensure that the survey panel accurately reflects the true structure of each economy in terms of sectoral contribution to GDP, regional distribution and company size. This panel forms the basis for the survey. The current report is based on responses from around 7,000 firms.

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