Economic Monthly Brief
August 2019
Insights into the month's economic news

MAKE uk
The Manufacturers' Organisation

Round up

GDP contracts in Q2

The first quarter of 2019 reported a 0.5% growth in GDP which reflected the artificial boost seen from stockpiling activities. This effect has now begun to subside, with the economy contracting for the first time since 2012 by 0.2% in Q2, highlighting the true impact of an approaching Brexit deadline (31st October).

On the other side, July saw the service sector showing signs of expansion, based on its PMI score recording a 51.4. Regardless, contractions in manufacturing (0.2%) and construction (0.7%) dominated GDP resulting in an economy wide decline. The biggest contributor of decline for these two sectors originated from a drop in business investment (0.5%) coupled with a decline in both domestic and international orders. Nevertheless, manufacturing output remained strong, albeit on a downward trend.

GDP fell by
0.2%
In Q2 2019

PMI stable but still negative

Manufacturing PMI was
48.0
in July

To some extent, stability in the PMI is positive news following consecutive months of decline. As far as we can observe, for the time being the downward trend has decelerated. Nevertheless, manufacturing maintains its position within contractionary zones.

Production and new orders remain low as many manufacturers continue to face the consequences of domestic and international political uncertainty, including a slowdown in growth as well as productivity.

According to the ONS, there are now 126,000 fewer workers (net) employed in manufacturing jobs today than in June 2016. Meanwhile the Bank of England estimates that UK productivity (output per worker) has reduced by 5%. Less workers who are less productive does not bode well for expected output levels in the coming months in the manufacturing sector. This particularly as firms are less willing to cover this gap through investments, which declined by 0.5% in Q2.

Inflation above 2%

Latest data reveal that CPI was at 2.1%, up from 2% last month. Analysts explain that the rise was associated with an increase in the cost of toys, games and accommodation; as well as clothing. However, this month's numbers equally reflect a tightening labour market, as average earnings increased by 3.9% while manufacturing earnings went up by 2.4%. As mentioned in our last bulletin, manufacturers currently prefer to invest in people over machines as a lack of available skill results in firms increasing wages to attract the best talent. Furthermore, firms prefer to invest in labour over capital to minimise sunk costs as they are unable to make accurate prediction on returns (ROIs).

Nonetheless, as reported above, there are fewer workers currently employed in manufacturing, and forecasts for 2020 suggest employment levels will fall slightly too.

CPI reported at
2.1%
In July

European PMI struggle to pick-up

Eurozone PMI was
46.5
in July

The Eurozone saw PMI fall from 47.6 in June to 46.5, achieving the fastest rate of contraction since 2012. As reported last month, Germany continues to be the most challenged nation as its individual manufacturing PMI is currently at 43.7, which is the lowest in seven years. Again, continued political uncertainty, particularly the US-China trade war have hampered the manufacturing capabilities of Europe.

Economist's Comment

Throughout the first half of this year we have regularly emphasised the impact that stockpiling activities have had on manufacturing performance. For many across the UK, winter had seemingly come earlier than anticipated as Brexit uncertainties barred decision-makers from effective planning. For now, manufacturers still benefit from these activities, although the pace has decelerated with a likely hangover period to follow in the coming months.

Manufacturing activities experienced stability, as confirmed by the latest PMI data from June to the end of July. However, as we have reached the end of abnormal stockpiling, without a subsequent increase in orders to meet the extra output, manufacturers will struggle to make room for further stockpiling ahead of the Christmas period. An increase in orders is looking increasingly unlikely as the biggest declines in orders came from both the EU and China, not to mention that a number of manufacturers have seen foreign companies moving supply chains away from the UK as Brexit chaos lingers on.

In particular, the UK automotive sector continues to suffer alongside the increasing probability of a "No deal" Brexit, given it is one of the major subsectors heavily reliant on international demand. Vehicles, which carry high unit costs, failed to benefit from weakened exchange rates. The reason – intermediate goods (i.e. the materials) used to make vehicles originate mainly from outside the UK resulting in higher importing costs as a result of weaker exchange rates.

Political uncertainty, predominantly the trade war between the US and China, continue to threaten many industries that go far beyond just UK manufacturing, as many international markets will feel the repercussions of the dealings between two economic giants in the near future. Additionally further concerns arising from oil tankers near and unpredictable Iran will likely be felt through oil prices. Depending on how these situations play out, UK manufacturers may witness further uncertainty in import prices that go beyond a weak exchange rate.

Data summary

	Period	Figure	Reference	Trend
UK GDP growth	2019 Q2	-0.2%	q-on-q	↓
UK Manufacturing PMI (Index)	2019 Jul	48.0	index	↔
UK Services PMI (Index)	2019 Jul	51.4	index	↑
Eurozone Manufacturing PMI (Index)	2019 Jul	46.5	index	↓
Make UK Annual GDP Forecast	2019	1.1%	y-on-y	↓
Make UK Pay Settlements	2019 May	2.6%	3m-on-3m	↔
Average earnings – manufacturing	2019 Jun	2.4%	3m-on-3m	↔
Average earnings – whole economy	2019 Jun	3.9%	3m-on-3m	↑
UK ILO Unemployment rate	2019 Jun	3.9%	%	↔
CPI inflation	2019 Jul	2.1%	y-on-y	↑
RPI inflation	2019 Jul	2.8%	y-on-y	↓
UK Consumer Confidence Index	2019 Jul	-11	index	↑
Index of Production	2019 Jun	-0.1%	m-on-m	↓
Index of Manufacturing	2019 Jun	-0.2%	m-on-m	↓
UK Trade - Goods balance (£billion)	2019 Jun	-7.1	level	↑
Business Investment growth	2019 Q2	-0.5%	q-on-q	↓
Manufacturing Investment growth	2019 Q1	-0.4%	q-on-q	↑
UK Debt to GDP level	2018 Q4	86.7%	GDP %	↑
UK Current Account Balance % of GDP	2019Q1	-5.6%	GDP %	↓

Sources: ONS, Markit, GfK NOP and Make UK