Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 20 3465 2672

UK UPDATE: SERVICES PMI AT 3 YEAR LOW ON BREXIT JITTERS, NO NEED TO PANIC

Berenberg Macro Flash

Markit/CIPS Services PMI, Apr 2016

Actual	**52.3**
Previous	53.7
Consensus	53.5
Berenberg	53.0

Three strikes in three days for the UK economy. The lowest reading for the UK services PMI since February 2013 makes for three in a row after construction and manufacturing indices also came in below expectations earlier in the week. The headline index for services was 52.3 in April, below the consensus of 53.5. Firms attributed slower growth to uncertainty about the forthcoming EU referendum on June 23. They reported that clients were delaying new contracts until after the vote. This is consistent with the commentary in the other April PMI surveys. There was evidence as early as Q4 last year that businesses were starting to pause investments ahead of the vote - business investment declined by 2.0% qoq. So far, consumers have been surprisingly resilient. But, with consumer-oriented services showing signs of slower growth, it looks like Brexit jitters are being felt by households now too.

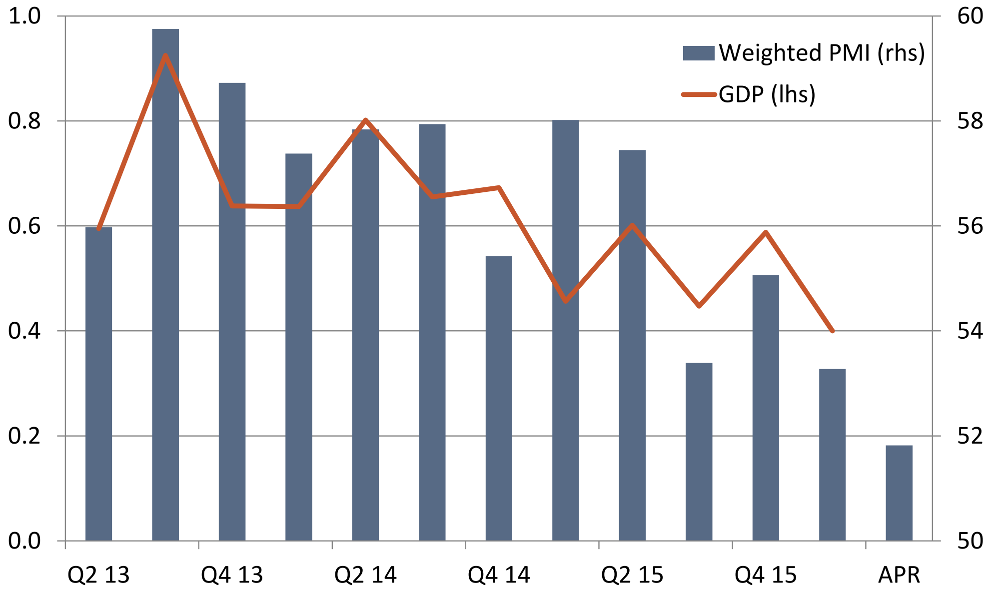
Stable gains in employment, continued recovery in inflation. While the manufacturing survey noted a decline in employment, construction and services (85% of the economy) suggested employment gains continued at a subdued pace at the start of Q2. In addition, the manufacturing and services surveys indicated a continued easing of deflationary pressure from input costs. Deflationary pressure from falling input costs – due to sterling-related falls in import prices and declining commodity prices - was a key contributing factor to the inflationary weakness that started in 2013. This data supports our view that the labour market should hold up through this period of mid-year uncertainty while inflation continues to recover.

Substantial downside risks to near-term growth. As Chart 1 shows, after stronger growth earlier in the recovery, growth has been stable at a trend rate of around 0.5% qoq since the beginning of 2015. In Q2, we look for growth of 0.4% again, following on from Q1. Even though our weighted PMI index has understated growth in last three quarters, data for the first month of Q2 suggests that there is still downside risk to our near-term outlook. However, monthly data can be volatile and soft data is often influenced by sentiment as much as the underlying economic performance. Indicators of consumer and business sentiment have declined in recent months owing to global growth concerns in Q1 and Brexit uncertainty in Q2. Nevertheless, they remain in line, or just above, their pre-crisis averages. And while the April PMI data looks weak relative to the recent past, they point to only a subdued rate of GDP growth, rather than a contraction.

Back on track in H2 if the UK stays in the EU. If, as we expect, the UK votes to remain in the EU, then the growth rate should recover to its trend rate of 0.5% qoq in the second half of the year. While there are some risks relating to the current account deficit and concerns that households are returning to pre-Lehman borrowing and saving habits, underlying fundamentals are sound. With the Brexit risk gone, households and businesses should be able to paint a clearer picture of the future, boosting confidence and allowing spending and investment growth to return to a normal pace. We see a 35% risk of a Brexit.

PMI	APR	MAR	FEB	JAN	DEC	NOV
UK Services	52.3	53.7	52.7	55.6	55.5	55.9
UK Manufacturing	49.2	50.7	50.7	52.9	51.8	52.4
UK Construction	52.0	54.2	54.2	55.0	57.8	55.3

Chart 1: Weighted PMI versus GDP



Source: Markit/CIPS, Berenberg calculations. Weights: 80% services, 15% manufacturing and 5% construction

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
Kallum.pickering@berenberg.com