UK service sector slows further as Brexit uncertainty builds

With Brexit uncertainty causing investment to decline, service sector activity has slowed as new orders become scarce. A lot will hinge on the events today in Westminster, but the bottom line is that risk of a 'no deal' Brexit on 31 October is unlikely to fade completely after this week. This will continue to keep the pressure on underlying growth

Source: iStock

At 50.6, the latest UK services PMI suggests that the sector is barely growing. With the exception of the July 2016 dip, business optimism is now at the lowest level seen since the financial crisis. So what does this mean for growth?

Well, IHS/Markit note that these PMI levels are usually consistent with a fall in output of -0.1% during the third quarter. Given the prospect of further volatility in the inventory numbers, this seems unlikely at this stage – we may see firms build stocks again ahead of the 31 October deadline, albeit at a slower pace than back in the first quarter (inventory levels are still reasonably high). This recorded as a positive for economic output, although of course is ultimately a temporary phenomenon.

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However, there's little doubt that the underlying pace of growth is likely to stay fairly lacklustre. Investment has been more-or-less consistently declining since the start of 2018, and this is a trend that is likely to persist. While the outcome of the coming 24-hours will be critical for the Brexit process, it seems unlikely at this stage that this week's events will fully take the 'no deal' risk off the table.

This uncertainty will continue to limit appetite to expand, and as firms continue to ramp up contingency activities in the run-up to the October deadline, resources available for possible investment projects will also be diminished.

For the services sector, this lower investment trend has reduced demand for the associated professional/financial services, according to the Bank of England analysis last month. The pace of new orders has slowed and firms are reporting that backlogs of work are falling. With wage and other input prices rising, IHS/Markit note that this is putting "intense" pressure on margins as firms don't have the power to pass these costs on. In turn, this suggests risks to hiring and capital spending within the sector over the coming months.

The upshot is that underlying growth is likely to remain fairly lacklustre over coming months. That said, barring a 'no deal' exit in October, we think it's still too early to be pencilling in UK rate cuts over coming months. Equally however, the prospect of further gradual tightening is becoming increasingly distant.

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