Weakest service sector performance since February 2021 as inflationary pressures continue to dampen demand

Key findings
Slowest output growth in 17 months of expansion
Employment rises markedly again, despite subdued order books
Input cost inflation softens to its lowest since December 2021

UK service sector activity growth eased to its slowest in the past 17 months during July as inflationary pressures and the cost-of-living squeeze resulted in heightened economic uncertainty. New business gains were limited as a result. Both operating expenses and average prices charged continued to rise at elevated rates, despite inflation easing considerably since June. Meanwhile, confidence about the future remained at an historically subdued level.

More positive news was the continued strength of the labour market, with jobs again added at a strong pace. That was despite continued challenges in the recruitment of suitably qualified staff.

The headline seasonally adjusted S&P Global / CIPS UK Services PMI® Business Activity Index posted above the 50.0 no-change mark for a seventeenth successive month in July. However, dropping to 52.6, from 54.3 in the previous month, the rate of growth signalled by the index was the lowest in this sequence and pointed to a noticeable loss of momentum compared to earlier in the year (the index peaked at 62.6 in March).

Despite improving marginally from June’s 16-month low, the rate of new business growth signalled by July’s survey remained much weaker than those seen previously. Whilst firms noted that underlying demand continued to increase amid a successful conversion of strong pipelines into contract wins, many service providers also noted that rising economic uncertainty and high inflation had constrained client budgets. Similar factors weighed on new export orders, although some cited higher sales to clients in North America and a boost from increased tourism.

Companies were broadly able to keep on top of overall workloads during July as evidenced by data on backlogs of work, which showed only a fractional increase since June. This was in part linked to another notable expansion in staffing levels, which rose in July for a seventeenth successive month.

Growth primarily reflected a response to recent increases in new work and business activity requirements. There were again reports of difficulties in recruiting and finding suitably qualified staff to fill vacancies. The net rise in employment was subsequently the lowest recorded by the survey since April 2021.

The need to retain staff and support employees through the cost-of-living squeeze were reported to have been a factor driving up wage expenses during July. With fuel and utility bills impacting input costs both directly and indirectly by raising the prices of goods and services in general, operating expenses continued to rise at an historically elevated rate. That said, inflation did ease on the record levels seen in May and June. Moreover, the latest overall rise in average cost burdens was the least marked since December 2021.

Despite reports of pressure to remain price competitive in the face of an uncertain economic climate, many firms saw little choice but to raise their own charges during July.

Finally, confidence in the outlook remained relatively subdued. Many survey respondents are optimistic that forthcoming business investment and the release of new products will support growth in the coming year. However, worries persist over the impact of high inflation, rising interest rates and recession risks for the UK and global economy. Measured overall, business optimism for the year ahead picked up slightly since June, but was the second-lowest since May 2020.
Comment

Tim Moore, Economics Director at S&P Global Market Intelligence, which compiles the survey:

“UK service providers reported their worst month for business activity expansion since the national lockdown in February 2021. Reduced levels of discretionary consumer spending and efforts by businesses to contain expenses due to escalating inflation have combined to squeeze demand across the service economy. The near-term outlook also looks subdued, as new order growth held close to June’s 16-month low and business optimism was the second-weakest since May 2020.

"The most encouraging development during July was a considerable slowdown in input cost inflation since the previous month, likely reflecting lower commodity prices and a gradual easing of global supply shortages. Overall cost burdens rose to the smallest extent seen so far in 2022, despite widespread reports citing pressure on operating expenses from higher fuel bills and staff wages. Any slowdown in inflationary pressures can’t come soon enough for service providers, with many firms reporting growing customer resistance to price hikes and a subsequent downturn in demand as higher energy, fuel and staff costs are passed on to customers.”

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

"The services sector was on a go-slow trajectory in July, with the weakest level of growth since February 2021, as some ongoing shortages and subdued new business gains hindered progress.

"Service firms responded with a downbeat view of the next 12 months, the second lowest since May 2020, aware that the looming threat of further interest rises and recession on the horizon is unlikely to encourage consumers to spend.

"A few bright spots in the figures, however, may offer some relief in terms of increasing operational capacity and managing business costs for the sector. The slowest rise in input prices since December 2021 hinted that we may be over the hump in terms of inflationary pressures at least and job seekers in need of work have the pick of the crop as employment levels continued to rise.

"A period of relative stability in terms of supply chain disruption was also a plus point, according to survey respondents. However, after the scramble to regain the heights in activity during the Covid bounceback loses momentum, the UK marketplace will have to improve much more to avoid a prolonged summer of discontent.”
At 52.1 in July, down from 53.7 in June, the seasonally adjusted S&P Global / CIPS UK Composite PMI Output Index* remained above the 50.0 no-change value for the seventeenth consecutive month. However, the latest reading signalled the slowest rate of expansion over this period (since February 2021).

New orders increased only marginally in July, reflecting subdued demand in both domestic and overseas markets. Latest data signalled a renewed decline in export sales, largely reflecting a reduction in new work from abroad across the manufacturing sector.

UK private sector firms signalled another steep rise in their average cost burdens during July, but the pace of inflation moderated to a ten-month low. Softer input price pressures and subdued customer demand contributed to the least marked rise in average prices charged since February.

Survey methodology
The S&P Global / CIPS UK Services PMI® is compiled by S&P Global from responses to questionnaires sent to a panel of around 650 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP. Data collection began in July 1996. Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of “higher” responses and half the percentage of “unchanged” responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

The headline figure is the Services Business Activity Index. This is a diffusion index calculated from a question that asks for changes in the volume of business activity compared with one month previously. The Services Business Activity Index is comparable to the Manufacturing Output Index. It may be referred to as the “Services PMI” but is not comparable with the headline manufacturing PMI figure.

The Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Composite Output Index may be referred to as the “Composite PMI” but is not comparable with the headline manufacturing PMI figure.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series. For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

Flash vs. final data
Flash services data were calculated from 79% of final responses. Since January 2006 the average difference between final and flash Services Business Activity Index values is 0.2 (0.7 in absolute terms).

*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.

Sources: S&P Global, CIPS, ONS.

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